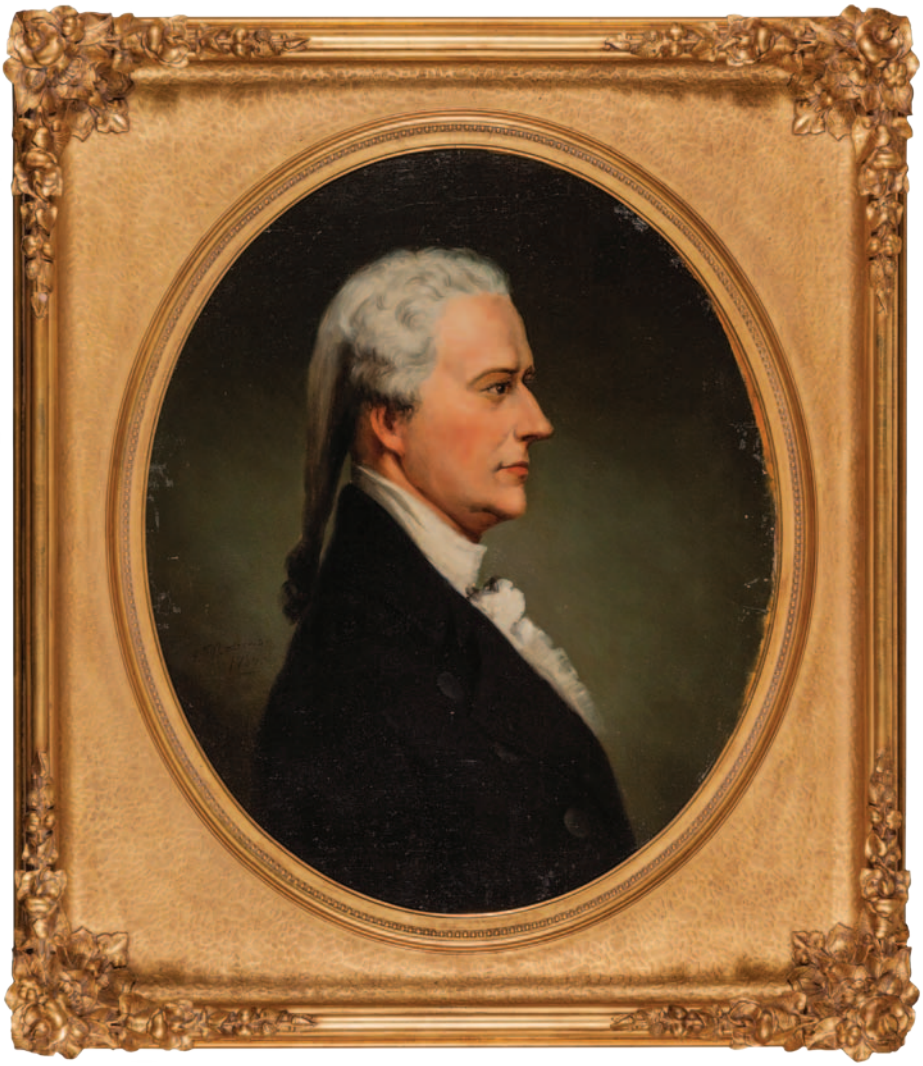
FINANCIAL HISTORY

THE MAGAZINE OF THE MUSEUM OF AMERICAN FINANCE



An Early History of High-Speed Trading

When Competition Was a Dirty Word

Capitalism and the Common Good

ISSUE 111 | FALL 2014 | $4.00

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A truly fantastic note which has been off the market since its last auction appearance forty-four years ago, this 1861 Demand Note is serial number one and is the first piece of United States Federal currency ever issued — achieved $381,875.

This 1861 Paquet Reverse Double Eagle, depicting a rare one-year type by Anthony C. Paquet, who redesigned the reverse of the Liberty double eagle for use on 1861-dated coinage, brought $1.645 million.



Heritage Auction's August 2014 U.S., World, Ancient Coins and Currency auctions at the American Numismatic Association World's Fair of Money in Chicago totaled over $49 million — the highest total for an ANA auction in history.



A 1787 New York Excelsior Copper, Indian and Eagle on Globe on reverse is the fourth finest of 10 known examples of this early New York State coinage — sold for $129,250.

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MU$EUM OF AMERICAN FINANCE

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ON THE COVER

Portrait of Alexander Hamilton by Eliphalet Frazer Andrews. September marks the 225th anniversary of Alexander Hamilton's appointment as the first US Secretary of the Treasury.
See related article, page 5.

Credit: Collection of John E. Herzog; Alan Barnett Photography.



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Opening Bell Signals Launch of Free Student Program



Message to Members

David J. Cowen | President and CEO

The start of fall means that our highly-successful summer program of free student admission has concluded. The program, fully funded by the firm of R.W. Pressprich, provided free access to the Museum for 3,444 students, enabling them to appreciate the value and power of finance to our country. To kick off the program, Ed Rappa — chairman and CEO of Pressprich and a trustee of the Museum — rang the NYSE opening bell, along with members of the Museum staff and the executive director of the Boys' Club of New York. Ed is also president of the Boys' Club, and the summer program included educational classes and tours of the Museum for members of the Boys' Club.

We have three pieces of exciting news to share on the forthcoming exhibit front, including two re-launches of existing exhibits. First, the Hamilton Room now features an exhibit curated by our founder, John Herzog. John has championed Alexander Hamilton for decades, has been an avid collector of Hamilton-related items and has compiled some of his favorite objects and documents in a display entitled "Alexander Hamilton: Indispensable Founder and Visionary."

Second, our board member Mark Shenkman has underwritten a re-launch of our "Money: A History" exhibit for Spring 2015. This exhibit will feature hundreds of examples of currency on loan from Mark's collection and will tell the history of America through the lens of paper money. This exhibit will utilize state-of-the-art technology with touch screens for further discovery. Currency dealer Dr. Arnold Saslow will be the guest curator of this exhibit.

Finally, in the second half of 2015 we will launch an exhibit on gold. We have received lead sponsorship of the exhibit from Steve Wozniak, co-founder of Apple and inventor of the personal computer, and Sidney Mobell, world famous jeweler and designer whose many works are in the collection of the Smithsonian National Museum of Natural History. Sid created the beautiful gold and jewel-encrusted Monopoly set currently on view at the Museum, which is a visitor favorite.

As a 501(c)3 non-profit, we depend on individuals and corporations for support, and we thank Bloomberg, Moody's and Protiviti for joining or renewing their corporate sponsorships this summer. It is imperative that we continue to engage the financial world, our natural base, for financial and other support. To assist in that engagement, Mindy Ross has joined our staff as Director of External Relations. Mindy brings a tremendous amount of Wall Street, marketing and other fundraising experience to the Museum, and we are excited to have her on board.

The 2015 Gala, our main fundraiser, will be held on January 13. We will recognize David Rubenstein with the Whitehead Award for Distinguished Public Service and Financial Leadership. For more information on this event, please contact Jeanne Driscoll at 212-908-4694. **$**



Ben Hider

Representatives from the Museum, R.W. Pressprich and the Boys' Club of New York rang the NYSE opening bell on June 11 to announce the launch of the Museum's free student summer admission program, sponsored by R.W. Pressprich.



AUG 5 1891 The first modern traveler's check is cashed, as American Express executive William G. Fargo countersigns check number 600002 for $50 at a German hotel.

AUG 8 1896 The Dow Jones Industrial Average, less than three months old, hits the lowest level ever recorded: 28.48, down 30.5% in 10 weeks.

"Alexander Hamilton: Indispensable Founder and Visionary" Display Commemorates 225th Anniversary of Hamilton's Appointment as Secretary of the Treasury



Collection of John E. Herzog



Collection of John E. Herzog

September 11, 2014 marked the 225th anniversary of Alexander Hamilton's appointment as the first US Secretary of the Treasury. To commemorate this occasion, Museum founder John Herzog and Alexander Hamilton Awareness Society (AHA) chair Mariana Oller guest curated a special display in the Museum's Hamilton Room entitled "Alexander Hamilton: Indispensable Founder and Visionary."

This new exhibit features objects from the Museum's first major exhibition, "Alexander Hamilton: First Secretary of the Treasury," which debuted on the bicentennial of Hamilton's appointment as first Secretary of the Treasury in 1989. A traveling version of the exhibit was also displayed at the Pequot Library in Southport, Connecticut, in 2013.

Objects from Mr. Herzog's personal collection are on view, including a rare manuscript check, an original copy of the first *Report on Public Credit,* an early Treasury bond with authorization to redeem signed by Alexander Hamilton, a vivid commentary on inflation from the period and a "horse bond" issued by Pennsylvania.

"The exhibit was very popular with students in Southport, and we hope there will be many more visiting the Museum to learn about Hamilton on this important anniversary," said Herzog.

"Alexander Hamilton: Indispensable Founder and Visionary" will be on view until early in 2015. **$**



Elsa Ruiz

Top left: $2 note featuring portrait of Alexander Hamilton, 1862. Bottom left: Drawing of George Washington meeting Alexander Hamilton. Above: The 225th Hamilton anniversary display will be on view in the Museum's Alexander Hamilton Room.

AUG 9 1995 The Internet stock sector is born as 16-month-old Netscape Communications Corp. goes public on the Nasdaq at an initial price of $28 per share.

AUG 11 1987 Alan Greenspan takes office as Chairman of the Federal Reserve.

AUG 28 1859 Edwin Drake strikes oil in Titusville, PA, setting off the "black gold rush."

Volunteer Spotlight: David Reitman

By Kristin Aguilera, Deputy Director



Kristin Aguilera

David Reitman in front of railroad bonds in the Museum's "Financial Markets" exhibit. David began volunteering at the Museum after retiring from a 35-year career in the railroad industry.

David Reitman has been a volunteer docent at the Museum for four years. As a member of the Visitor Services team, David leads tours for classes and adult groups every Tuesday. He also provides guided tours for Museum visitors in the recently-introduced public tour program, which offers free tours twice daily for visitors.

Unlike many of the Museum's docents, David's background is not in finance, but rather in the railroad industry. He spent 35 years working in the sales and marketing departments of the Norfolk Southern Corporation's New York office. There, he was responsible for selling transportation on Norfolk Southern's freight trains, which competed for business with trucking companies, steamship lines and other railroads.

A Brooklyn native, David was always interested in transportation, and he obtained his industry training at the Traffic School of New York. He also attended Brooklyn College, where he earned a B.A. in Speech with minors in Television and Radio Production.

Upon his retirement from the railroad industry, David sought out interesting volunteer opportunities to fill his time. He volunteered at a few organizations, including a theater group in New York, before seeing the Museum's ad on a local volunteer website.

In September 2010, David began training as a Museum docent, under the tutelage of veteran docent John Cirincion (see Volunteer Spotlight, *FH* issue 106). He quickly absorbed the subject matter and began giving tours later that year.

David said his favorite aspect of volunteering at the Museum is that he is constantly learning from the people, exhibits and artifacts he encounters there. He particularly enjoys the "Money: A History" exhibit and loves learning about Alexander Hamilton and trading history. He also regularly attends Museum events and classes, which have enhanced his understanding of the subject matter.

When he is not volunteering, David works in a bicycle shop once a week and is an avid bike rider. He participates in long-distance rides once a year and recently returned from an 11-day, 700 mile ride from Wilmington, North Carolina, to New York. He also enjoys sailing and has a 28-foot sailboat in Long Island Sound. **$**



SEP 2 1974 President Gerald R. Ford signs into law the Employee Retirement Income Security Act (ERISA), which creates a limited Individual Retirement Account (IRA) and opens the door to the creation of 401(k) plans in 1981.

SEP 8 1916 The US Congress enacts the Revenue Act of 1916, creating the federal estate tax.

High School Intern Designs App for MoAF Scavenger Hunt

By Kristin Aguilera, Deputy Director

High school students — and any Museum visitors with an Android phone — can now participate in an app-based version of a scavenger hunt of the Museum's permanent exhibits. The app was designed by 17-year-old Alexander de la Vega, a student from City as School (a New York City public school), who has been interning at the Museum since January.

"In the year or so that I've been working at museums, I've developed an understanding that museums can be great places for younger people to learn," said de la Vega. "By developing this app, I wanted to bridge the gap between the traditional museum experience and the technology that teenagers like me are comfortable with."

The scavenger hunt app was de la Vega's final project, required by his school to get credit for the internship. In determining what project to pursue, he worked closely with the Museum's education department to find a real need at the Museum to fill. Prior to the launch of the app, the Museum's scavenger hunt was paper-based, requiring teachers to manually check each student's sheet to determine his or her score. The app now automatically tallies the results and saves each student's high score on his or her device.

The nine-question scavenger hunt includes one question from each main exhibit area and leads visitors through the entire Museum. It is currently available as a multi-platform Android app and may also be available for IOS in the future. $



High school intern Alexander de la Vega — shown here interacting with visitors in the Museum gallery — developed an app of the Museum's scavenger hunt as his final project.



SEP 14 1960 President Dwight D. Eisenhower signs into law the Real Estate Investment Trust Act of 1960, which enables retail investors to buy shares in commercial real estate for the first time.

SEP 16 1920 Wall Street comes under attack as a massive charge of dynamite in a horse-drawn wagon explodes in front of the Wall Street headquarters of J.P. Morgan & Co., killing 30 and injuring hundreds.

Museum Adds Six New Courses For Fall 2014 Semester



Elsa Ruiz



Elsa Ruiz

Director of Education Chris Meyers teaches students in the Museum's Center for Financial Education.

By Chris Meyers, Director of Education

The Museum has added six new courses for the Fall 2014 semester, enhancing its already strong financial education program offerings for elementary though graduate-level students. The new classes include:

- **"The Market"** — An interactive trading experience designed to teach students the mechanics of trading markets, the interplay between profit-seeking individuals and the economics of market pricing
- **"The Incredible Shrinking Coin"** — Collecting expert and museum educator Harley Spiller, a.k.a. "Inspector Collector," shares how he discovered the many rules that govern our money, as well as the fascinating techniques and technologies used to protect currency from counterfeiting in this hands-on, interactive class for middle school students
- **"Booms, Bubbles and Busts"** — Seen through the lens of editorial cartoons from the Museum's collection as well as other sources, students learn how to interpret political cartoons and how to find common threads through history to identify booms and busts. A Ruth Baker Financial Education Intern developed this class.
- **"Intro to Capital Markets"** — Primer on the financial markets, from the establishment of ancient markets through the transition to modern electronic markets
- **"Financial Products"** — Using historical context, this presentation helps students with no background in finance understand the creation, counterparty relationship and cost/benefit of several financial products
- **"History of Derivatives"** — A look at the fascinating and little-understood history of derivatives, from ancient times to today

Financial education is at the heart of the Museum's mission. For more than 20 years, educators from around the world have been bringing students to the Museum to help them understand how finance impacts their daily lives. The Museum's Center for Financial Education features a variety of programs, including more than a dozen classes, the Museum Finance Academy after school program and a P-Credit course for NYC teachers.

All programs are taught by museum educators and market professionals. Thanks to generous support from ING, Title 1 Schools booking their visits in advance receive free admission, classes, transportation and lunch. For more information on the Museum's educational programs, or to book a group visit, please visit www.moaf.org/education. **$**



OCT 18 1873

Jay Cooke & Co. of Philadelphia, one of the nation's largest investment banks, collapses as a result of failed speculations in railroad stocks — triggering the Panic of 1873.

OCT 24 1917

The second Liberty Loan Act authorizes the US Treasury to issue more debt to pay for World War I. The Treasury creates 25 cent savings stamps that citizens can buy at post offices and banks, and the program raises $1.6 billion.

Depression-Era Scrip

By Davida Herschkopf

The Great Depression is remembered for the devastation it brought to the American people. Joblessness, homelessness and debt plagued the country, but even when hundreds of banks closed, Americans found a way to continue commerce with local currencies called "scrip."

The closing of American banks was both an early effect of the Great Depression and a factor that grossly exacerbated it in the early 1930s. Between December 1930 and the "banking holiday" that President Roosevelt declared in March 1933 — which shut down the entire national banking system — about half of the banks in America either closed or merged with others.

Surviving banks cut back drastically in their deposits and loans, contributing to a decline in money supply, and causing people to hoard their cash rather than entrusting it in a banking system that was rapidly deteriorating.

Hoarding effectively removed money from circulation, further contributing to the deflation that characterized the Depression era. With decreasing cash availability and with money worth markedly less than before, Americans turned to local currencies to carry out daily commerce.

Depression-era scrip was issued by local governments, businesses and even individuals. The scrip spurred local economies by being most valuable in the community that had issued it. Some store owners accepted scrip issued in other neighborhoods, but usually at a highly inflated rate to compensate them for the risk of the currency being invalid elsewhere.

Scrip was issued on a variety of materials, including paper bills, wooden tokens or bills, animal skin, fish skin parchment and even seashells. Though local currencies existed in America long before the Great Depression, and some even today, Depression-era scrip played a vital role in reviving local businesses and keeping their owners and employees from suffering the worst blows of the Depression.

The Museum holds a significant collection of Depression-era scrip representing a variety of issuers and materials from communities across the United States. Shown here are a few of our favorite examples from the collection. **$**

Davida Herschkopf graduated with a BA from Washington University in St. Louis and is currently a first-year student in the Program in Museum Studies at New York University. She worked as the Museum of American Finance's Collections Intern this summer.



OCT 25 1972 The first issue of *Money* magazine appears on newsstands.

OCT 26 1955 President Dwight D. Eisenhower suffers a heart attack, and the stock market plunges by 6.62%. This remains one of the worst daily losses of the past 100 years.

MU$EUM OF AMERICAN FINANCE

FALL 2014 EVENTS

Oct 18 Annual Great Crashes Walking Tour. 1:00 – 4:00 p.m. $15 includes Museum admission.

Oct 24 Walking Tour: Scandals and Scoundrels. 11:00 a.m. – 2:30 p.m. $15 includes admission to the Museum and the Lunch and Learn with Fred Fuld III.

Oct 24 Lunch and Learn Series: Fred Fuld III on "Wall Street Trivia." 12:30 – 1:30 p.m. Talk followed by book signing. $5 includes Museum admission; members and students free.

Oct 29 Evening Lecture Series: Tim Geithner on *Stress Test: Reflections on Financial Crises*. 5:30 – 7:00 p.m. Talk followed by book signing and reception. Please visit the Museum's website for event details .

Nov 5 Lunch and Learn Series: Charlotte Beyer on *Wealth ManagementUnwrapped*. 12:30 – 1:30 p.m. Talk followed by book signing. $5 includes Museum admission and a free e-book; members and students free.

Nov 12 Lunch and Learn Series: Pulitzer Prize winner Edward Larson on "Thirteen States or One Nation: George Washington and the Economics of the Confederation." 12:30 – 1:30 p.m. Talk followed by book signing. $5 includes Museum admission; members and students free.

Nov 17 Evening Lecture Series: Lawrence Cunningham on *Berkshire Beyond Buffett,* in partnership with the New York Society of Security Analysts (NYSSA). 6:00 – 8:00 p.m. 1540 Broadway (at 45th St.), Suite 1010. $20 discounted tickets available for Museum and NYSSA members.

Nov 25 Lunch and Learn Series: Jeffrey Rubinstein on "Evacuation Day, Alexander Hamilton and the Lost Deed to Manhattan." Talk followed by book signing. 12:30 – 1:30 p.m. $5 includes Museum admission; members and students free.

Register online at www.moaf.org/events. For more information, please contact Tempris Small at tsmall@moaf.org or 212-908-4110.



When Competition Was a Dirty Word

By Dan Cooper and Brian Grinder

Every man assumed to struggle hard to get all of the business… even though in so doing he brought to himself and the competitors in the business nothing but disaster.

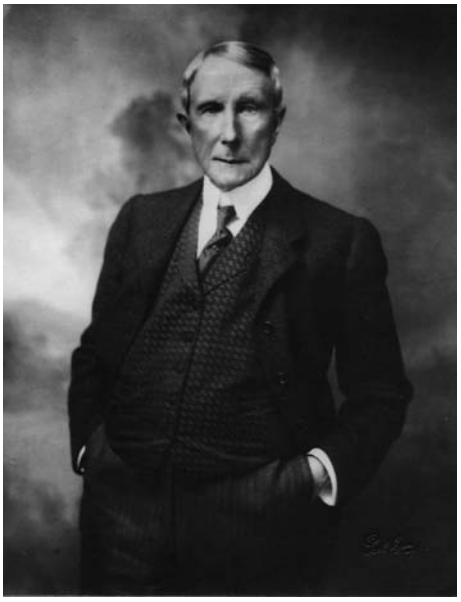
Oftentimes the most difficult competition comes, not from the strong, the intelligent, the conservative competitor, but from the man who is holding on by the eyelids and is ignorant of his costs, and anyway he's got to keep running or bust!

— John D. Rockefeller, Sr.

Oil tycoon John D. Rockefeller, Sr. was no fan of competition. He believed that "ruinous competition" had been such a disruptive force in the early days of oil production that it threatened the very survival of the nascent industry. His solution was to cooperate through a cartel that would stabilize prices by reducing overproduction. Historian Allan Nevins cites two reasons for Rockefeller's aversion to competition: ease of entry and blackmail. Nevins notes that in the late 1800s, a firm producing 3,000 barrels of oil per week could be established for $50,000 or less. This ease of entry tempted many of Rockefeller's competitors, or "blackmailers," to enter the industry solely for the purpose of selling out to Rockefeller's Standard Oil Company at inflated prices. According to Nevins, the Rockefeller interests believed that they could maintain an orderly market if they limited outsiders to no more than 20% of production.

Today most people assume free competition has always been favored by American businessmen. However, according to historian Ron Chernow, the revolt against free-market capitalism during the Gilded Age was led by "businessmen who couldn't control the maddening fluctuations in the marketplace." Furthermore, ruinous competition was not unique to the oil fields. In 1920, economist Eliot Jones analyzed the effects of competition on several different industries, noting its especially pernicious effect on the railroads. He wrote, "It is a generally accepted view that competition among railroads, unless restrained, tends to become 'ruinous,' that is, fails to establish a normal level of rates sufficiently remunerative to attract the additional investments of capital that recurrently become necessary."

Railroads, unlike oil, were protected by high barriers to entry because building and maintaining a railroad system required a huge fixed cost investment. According to author Larry Haeg, "Railroads represented the largest investment of capital in any enterprise in human history, equaling about one-eighth of the total wealth of the United States."



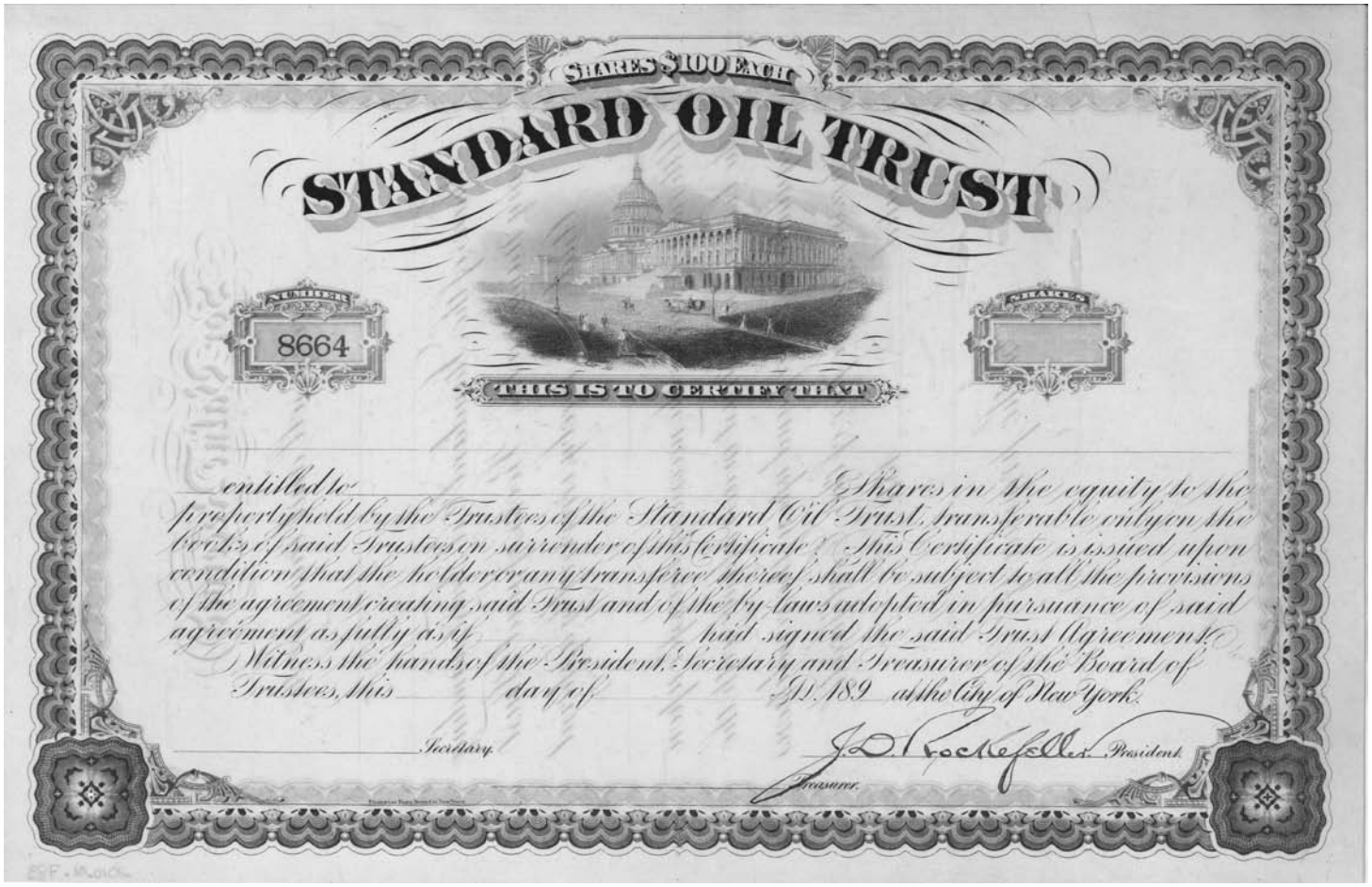
John D. Rockefeller, Sr.

Competition was somewhat limited in the early days of the railroads because the builders, promoters and financiers of the first railroads in the United States were only focused on providing local rail service. This attitude, according to railroad historian Christian Wolmar, meant that before the Civil War, travel by rail was relatively easy within a given state, but traveling beyond a state's borders was problematic because railroad gauges varied from state to state.

The war itself was a catalyst for a standardized national rail system, as both sides in the conflict relied heavily on the railroads to transport troops and materiel across the war-torn nation to the various fields of battle. Developing a national railway system led to fundamental changes in how railroads were managed and how they interacted with each other. According to Wolmar:

> As railroad companies expanded to serve national rather than local interests, the idea that it was better for a railroad to have a separate gauge from its local rivals had become redundant. Cooperation rather than confrontation was now the watchword. Railroads work best as an integrated system: the longer that passengers and freight can travel without changing trains, the better the service.

The general public, however, developed a growing sense of alienation and unease as the character of the industry changed from a local business that cared about the needs of the local economy to a large and impersonal corporate entity that seemed to care more about returns to shareholders than local needs. The scandals and corruption that developed during the building of the first transcontinental railroad only added to this perception. According to Wolmar; "During the final quarter of the 19th century, the railroads became, first, disliked and, then, widely resented."



Museum of American Finance

Standard Oil Trust stock certificate signed by John D. Rockefeller as president.

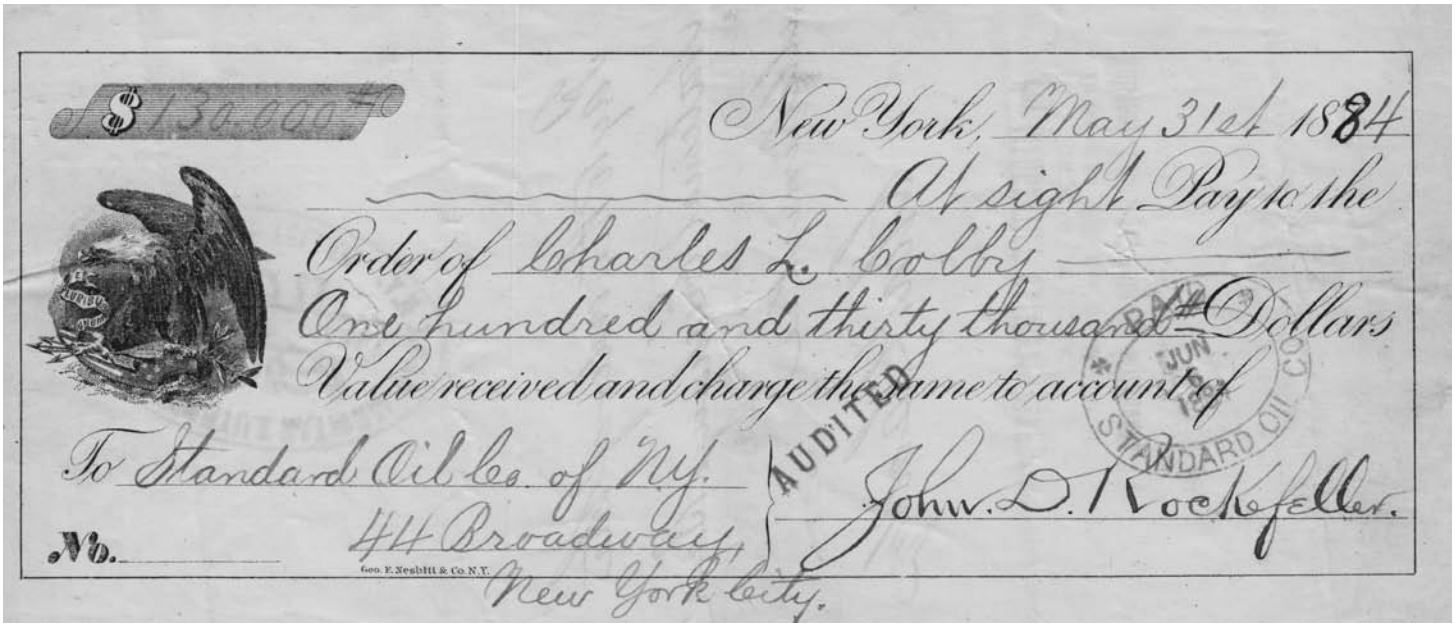
At first, the large railroad trusts seemed unstoppable. Even the creation of the Interstate Commerce Commission (ICC) by the federal government in 1887 failed to stem railroad consolidation. The ICC, according to historian Maury Klein, was charged with several incompatible missions. "It tried both to prevent monopoly by enforcing competition and to outlaw [rate] discrimination… however, a policy designed to preserve competition also perpetuated discrimination."

In the beginning, the ICC was wholly ineffective as railroad lawyers effectively exploited loopholes in the very legislation that had created the ICC. It was feared that monopoly was inevitable, as J.P. Morgan led the charge to consolidate the industry with the creation of the Northern Securities Company trust. A new era of cooperation dawned as an informal "community of interest" developed between the most powerful names in the industry. According to Haeg, "Almost every board of a major railroad, except [James] Hill's Great Northern, was stacked with directors from other roads."

The assassination of President William McKinley in 1901 changed the course of events by bringing an energetic and powerful force into the White House in the form of trustbuster Theodore Roosevelt. Under Roosevelt, the ICC became more aggressive and would ironically, according to Haeg, morph "into a government monster that essentially created cartels in regulated industries by raising prices, limiting consumer choice and reducing efficiency." But the president couldn't wait for the revitalized commission to take action and filed suit against Northern Securities himself. The era of cooperation was over, and government enforced competition was on the rise.

Klein contends that "no concept except democracy has been more extolled and less understood by Americans than competition." Americans have had a longstanding love affair with competition in spite of the fact that there are documented instances where it has led to inefficiencies and waste. Many have spoken out against the idea of the superiority of competition over other market models. In an 1899 speech, former ICC Chairman Martin Knapp expressed his belief that, "The benefits supposed to result from railroad competition [are] greatly exaggerated…we cannot have that free and fair competition in trade without methods and rates for public transportation which amounts to a monopoly."

Aldace Walker, a former ICC commissioner, agreed that free competition "sounds



Museum of American Finance

Standard Oil Company check signed by John D. Rockefeller, May 31, 1884.

well as a universal regulator, but it regulates like a knife. Unless the weapon in turn itself is held in check it is too dangerous an agency to be endured." Finally, 19th century railway authority Charles Francis Adams, Jr. concluded that "…competition and the cheapest possible transportation are wholly incompatible."

Klein reached the surprising conclusion that, "The market mechanism seems to be popular so long as it produces good news. When it produces bad news, however, a clamor for restraint and regulation arises. Put another way, the true American obsession is with winning, not competing. We relish, even glorify competition in the abstract until we come out losers from it—and historically we have been poor losers."

Perhaps there is some truth to Klein's contention that Americans are sore losers. However, both corruption and abuse of power have a tendency to increase as a corporation begins to dominate its market. Such abuses cannot be ignored. The question is how should government respond?

History shows that a government enforced return to a competitive market structure is not the answer when an industry is threated by monopolistic forces. Moreover, overregulation must be avoided because it places undue burdens on the offending industry and stifles innovation and growth. A balanced approach that includes external regulation, internal control mechanisms and public pressure is the most desirable solution; achieving that balance, however, is very difficult.

Haeg agrees that the state must be able to "supervise and control" large corporations with monopolistic tendencies, but he warns, "The right should be exercised with caution and self-restraint."

Unfortunately, caution and self-restraint are all too often in short supply in the halls of government. **$**

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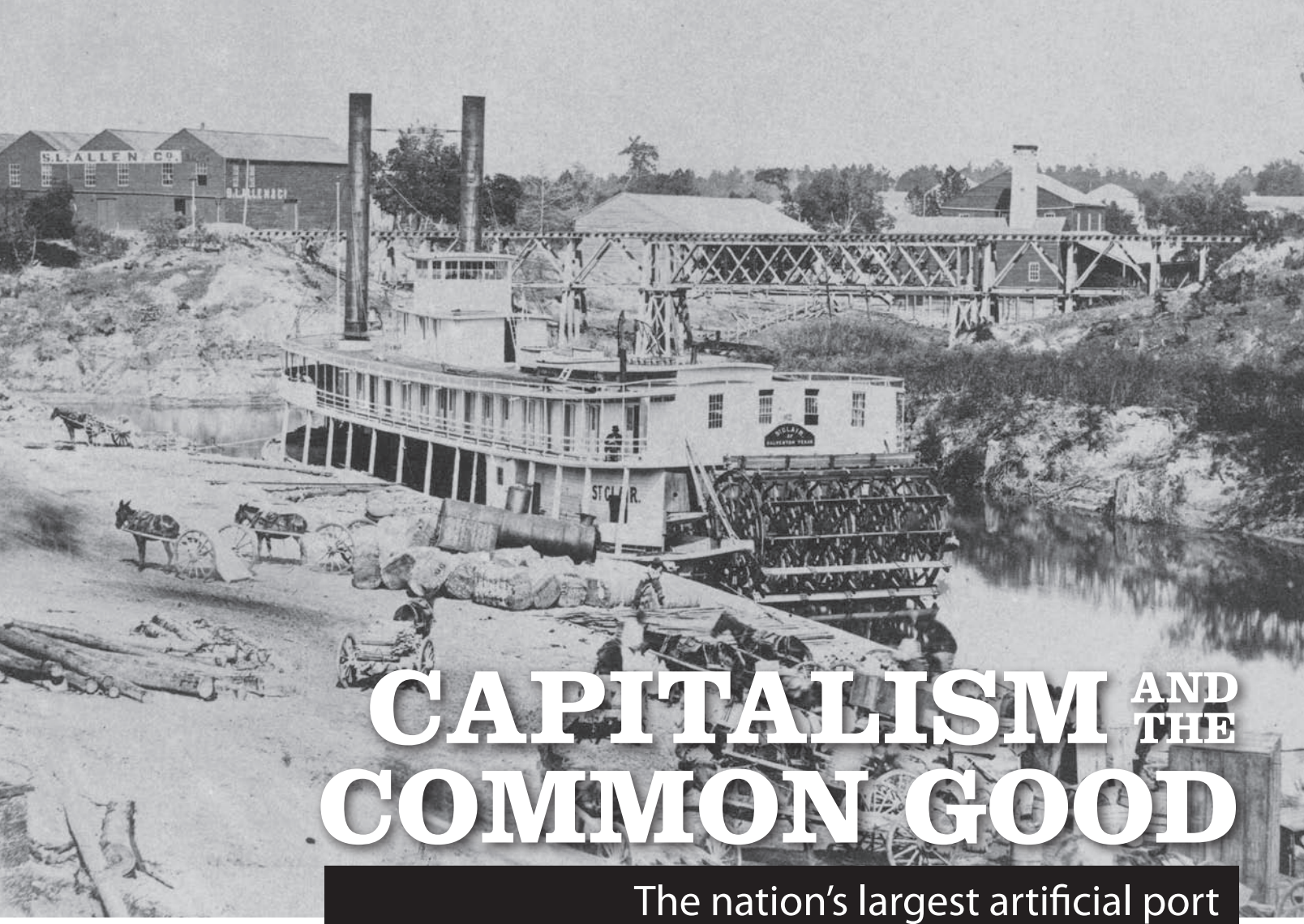
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CAPITALISM AND THE COMMON GOOD

The nation's largest artificial port was a 50:50 public–private venture

By Holly Beretto and Gregory DL Morris

Two magisterial feats of engineering celebrate their centennial this year: The Panama Canal and the Houston Ship Channel. "A man, a plan, a canal: Panama!" justifiably echoes through history as a seminal achievement in logistics, construction, medicine and sheer tenacity (and as a long palindrome).

In marked contrast, the Houston Ship Channel has remained known but unregarded, even in a state notorious for its boosterism. Centennial celebrations of several kinds are taking place in Houston this year to help remedy that oversight, but the ship channel should be remembered not just as a big dig that created a booming hub of industry and commerce, but also because its genesis was an unprecedented plan for financing the project.

At a time when local interests would contribute a token 5% or 10% or ancillary improvements to support public works, a Congressman and a financier devised a plan to make the ship channel a 50:50 venture between the federal government and local business interests. At the time it cost $2.5 million, or approximately $73 million today.

In rural Texas there is a common expression: "If you can't run with the big dogs, you'd better stay on the porch." At the turn of the century, the big dogs on the US Gulf Coast were the thriving port cities of New Orleans and Galveston. When the Great Storm of 1900 destroyed Galveston, residents ambitiously rebuilt the town. Less than a year later, oil was discovered near Beaumont, Texas, and speculative capital poured into east Texas.

Sixty miles up Galveston Bay lay Houston, a town no less ambitious than its namesake. Connecting the dots geographically and financially, business leaders in Houston devised a plan to create what was to become the largest man-made port in the country. Its champions were Representative Tom Ball of the first district of Texas, a lawyer, banker and three-term mayor of Huntsville who moved to Houston in 1902; and Jesse Jones, a local who never finished grade school but who became a rainmaker in finance, construction and politics.

Today a quiet tourist town of genteel shabbiness, Galveston was the largest city in Texas in the mid-1800s. While eclipsed in population, it remained the business, financial and cultural center of the state and the entire Southwest until September 8, 1900, when a massive hurricane all but

Sternwheeler "Saint Clair" at the foot of Main Street, Houston, 1856.



Port of Houston Authority

Houston Ship Channel turning basin, looking east to the I-610 Bridge and refineries beyond.

Port of Houston Authority

erased the city and killed between 6,000 and 8,000 people. The city's population at the time was only 37,000, so even the low end of the estimate comprised 16% of the residents. To put that into perspective, if Hurricane Sandy had killed 16% of New York's population, the death toll would have been 1.33 million.

That storm remains the worst natural disaster in US history, another largely unknown record. And while Galveston's reconstruction efforts were heroic — they built a seawall and raised the entire city 17 feet — the state business community, led by oil and railroad interests, began thinking about alternatives.

"It was really a perfect combination of things that made the Houston Ship Channel," said Tom Kornegay, former executive director of the Port of Houston Authority who is currently serving as the chairman for Promote Houston Ship Channel 2014, a non-profit dedicated to the centennial. "The Storm of 1900 leveled Galveston and sent everyone looking at ways to make an inland port — one that would be safe from hurricanes — a reality. The funding split between the federal government and the city of Houston was reached, and then there was a little thing called Spindletop over in Beaumont, which ushered in the region's oil industry. It's fair to say that the ship channel made Houston — and Houston made the ship channel."

Kornegay's take on history bears out. In 1914, Houston was barely 80 years old and still struggling against its backwater swampland image. Founded in 1836 by brothers and New York real estate developers John Kirby Allen and Augustus Chapman Allen along the banks of Buffalo Bayou, the site would, five years later, be named a port.

Brought into existence at the confluence of White Oak Bayou and Buffalo Bayou, two of the chocolate waterways that threaded through the fledgling city, the landing proved a natural turning basin where steamships would eventually dock. In 1910, as the Port of Houston project began after federal funding was approved for dredging a ship channel, the turning basin would be moved four miles east of the city's founding site.

When it opened on November 10, 1914, three months after the Panama Canal, the Houston Ship Channel ushered in a new era for the sleepy Southern city. In addition to the burgeoning oil business, Houston became a center for cotton exporting, bringing crops into the port from across Texas and the South, and sending the staple out across the sea to the rest of the world.

"In its early days, you'd see images from the 1920s, of guys pushing bales of cotton up the ramps at the channel, loading them onto ships," Kornegay said. "As time went on, there came forklifts, then cranes and ultimately containers. The first container move in the country happened in 1956, from New Jersey down to Houston."

As Houston grew throughout the 20th century, the ship channel made the economy of city life possible, and it still does. Eighty-five percent of the activity on the Port now is related to the energy sector, cementing Houston's reputation as the Energy Capital of the World. Cotton goods, autos and supplies, imports and container traffic still play a role. And Houston's port is one of a few that handles both imports and exports.

The city will celebrate the ship channel's importance in a rededication ceremony on November 10. The invitation-only event will take place at Brady's Landing, a popular

waterfront restaurant that sits next door to the site where the channel was inaugurated. In September, there was a day of festivities dedicated to the port and port businesses, with equipment exhibits, US Coast Guard rescue demonstrations and fireboats. And not far from Allen's Landing, in downtown Houston, there is a multi-media exhibit called "Stories of a Workforce: Celebrating the Centennial of the Houston Ship Channel," which will be on display at the Houston Public Library's Julia Ideson Building until January 15, 2015. Made possible by a Library of Congress grant, it features photos and video interviews with generations of ship channel workers, as well as maps, ship models and work gear that showcase how the ship channel dominates Houston life.

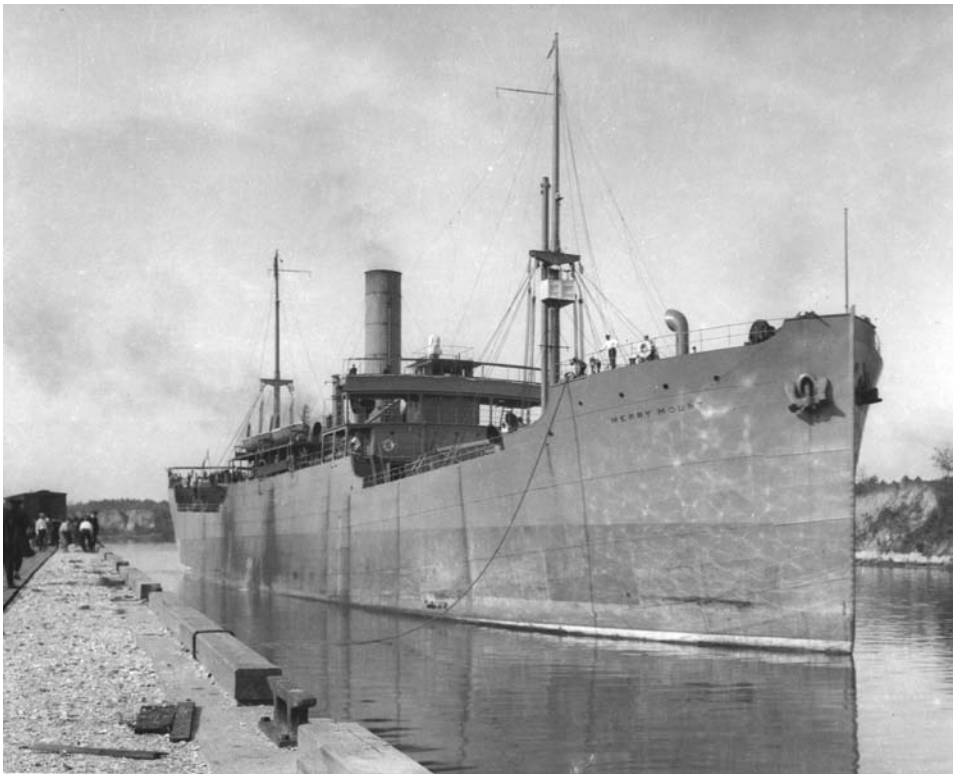
"I've often told people when I'm giving talks, name me anything in Houston and I'll show you how it relates back to the ship channel," said Kornegay. "This is where our city comes from."

In turn, the ship channel relates back to Ball and Jones. Local historian Leslie Upchurch said it was Rep. Ball's idea that the city of Houston and the government share costs on construction of the ship channel. Even though Ball left Congress in 1903, his idea — known as the Houston Plan — had taken root. Eleven years later, the ship channel would be built, funded in the cost-sharing way he had envisioned and earning him the nickname "the Father of the Port."

When he left Washington, Ball went on to serve as attorney for the Trinity and Brazos Valley Railroad. While there, he convinced the railroad to lay track through the then-farming community of Peck, northwest of Houston. The townspeople were so grateful for his efforts, and the new opportunities the railroad provided, they renamed the town Tomball in his honor in 1907.

What was once a tiny bedroom community is today a bustling small city. Oilfield services firm Baker Hughes recently announced the relocation of its Western Hemisphere training center to Tomball, likely bringing up to 70,000 employees through the facility every year. Situated along Texas Route 249, the city is set to be a growth corridor between northwest Houston and Waco.

Ball was encouraged by the president of the Anti-Saloon League to put his hat in the ring for Democratic nominee for governor in 1914. He lost to opponent James E. Ferguson, who would later be impeached. Ball became general counsel to the Port Commission of Houston, working to help the ship channel he supported be a continued success.



Port of Houston Authority

Steamer "Merry Mount" with the first direct shipment of cotton to Europe from the Houston Ship Channel, 1919.

Jesse Jones's fingerprints are all over Houston. With barely an eighth grade education and a background in working in tobacco fields, he rose to become one of the most influential men in the country. His exploits reached across the worlds of finance, construction and politics.

The myriad buildings that bear the Jones name are a legacy of his driving force in the Bayou City's early 20th century history. In the middle of the city's economic slump in 1907, he built the Texas Company Building, which helped turn Texaco into a household name and make Houston a natural home for the petroleum industry that still defines the city's personality.

Five years before wrestling the city to pitch in funds for the ship channel project, Jones constructed the building on Texas Avenue that would go on to house the *Houston Chronicle*, today the city's daily newspaper, for more than 100 years. The paper is moving operations late next year to a building that was once the home of its now defunct rival, the *Houston Post*.

Jones purchased the Rice Hotel from the eponymous university, razing it and erecting a 17-story replacement on the site, which opened in 1913. Today, after a long period of empty decrepitude and doubt, the building now known as Post Rice Lofts is one of downtown Houston's most desirable addresses.

Jones and his wife, Mary Gibbs Jones, are the founders of the Houston Endowment, a non-profit organization that provides funding to a wide array of Houston arts and civic groups. The Sam Houston Tollway, which rises majestically over the ship channel, was originally named the Jesse H. Jones Memorial Bridge, an homage to the financier's bold plan to share funding for the channel with the federal government.

"He built Houston up from a one-night stand on Buffalo Bayou into the second-largest and fasting growing metropolis in the South," read a 1940 *Fortune* magazine article. "Jones was instrumental in financing the Houston Ship Channel, and he was responsible for building the wharves and piers that welcomed ships from around the world. The ship channel elevated Houston's stature and economy and filled up Jones's buildings, including the headquarters for Texaco and Gulf Oil and the Rice Hotel," *Fortune* concluded.

"Jones was an avowed capitalist — that's what he listed as his occupation on his poll tax receipts — and he knew he would



Port of Houston Authority

Shuttle orbiter replica "Independence" (originally named "Explorer") in route to the Johnson Space Center, June 2012.

not prosper if people were not educated, gainfully employed and able to participate in the local economy," said author Steven Fenberg in a 2011 interview with the *Texas Observer* discussing his book, *Unprecedented Power: Jesse Jones, Capitalism and the Common Good.*

In 1987 the Houston Ship Channel was named an "historic civil engineering landmark" by the American Society of Civil Engineers (ASCE). "Tom Ball and Jesse Jones were a real one-two punch," said Jerry Rogers, professional engineer and former member of the ASCE History & Heritage Committee who is now retired after 43 years of teaching at the University of Houston.

"A 50:50 match had never been offered on a public works project, Rogers said. "When Ball offered that to the federal Rivers & Harbors Board, the project was approved unanimously. After that approval, Jones took it upon himself to convince each bank in Houston to take its allotment of the bonds that would fund the private half. He got commitments for the full $1.25 million in about 24 hours."

The ship channel was "probably the first extensive man-port in the country," Rogers said. "It was built at the same time as the Panama Canal, and there are historical reports that during one month more material came out of the dredging of the Buffalo Bayou than came out of the Panama Canal excavation." He noted that he has not seen original documentation on that, but still, the claim shows the builders of the ship channel knew they were building a world-scale project.

That said, the Panama Canal overall was several times larger than the Houston Ship Channel. One possible explanation for that eyebrow-raising excavation claim is that the Houstonians used hydraulic dredging, basically sucking up material from the bottom and pumping it through pipes to a dump spot. In a small irony, that technique was used on a large scale just a few years before and a few miles away to raise the grade of Galveston after the hurricane. It is conceivable, then, that in a one-month flurry, the ship channel could have sprinted ahead of the Panama project, which primarily used steam shovels to dig and railcars or trucks to haul material.

Joe Hrametz, chief of operations for the US Army Corps of Engineers, Galveston District, said he is dubious of the excavation volume claim but agrees that the ship channel stands as a milestone of public-private collaboration as well as an engineering monument. Those themes continue, he added. "The project to deepen the channel to 45 feet [from its original 25 feet] that began in 1998 was the first to work through an inter-agency coordination team, bringing together federal, state and local resource organizations. They all sat down with the corps to create an environmental plan for the dredge disposal."

"We have built out 1,800 acres of beneficial use," including marshes, oyster beds and islands that serve as breakwaters and bird sanctuaries, said Hrametz. It is a sign of the times — so different from a century ago — that environmental considerations are mentioned first, but economic considerations are never far from mind. The corps is responsible for all navigable waterways in the country.

"The throughput for the ship channel for deep sea vessels is 60 to 80 calls a day," said Hrametz. "For barges it is 350 to 400 transits a day. We get roughly $25 to $30 million a year to maintain the greater Houston system. The Port of Houston is known to be huge in petroleum, chemicals and steel, but is also a major container port."

Rex Sherman, director of research and information services at the American Association of Port Authorities, confirmed that the Port of Houston is the largest port in the country in terms of foreign trade. "The ship channel went into business just as Texas was emerging as an oil economy, and for a century the port has been linked to the petroleum business." According to ASCE, eight refineries had been built along the ship channel within 16 years of its opening.

Sherman also noted some synergy with the Panama Canal. "The two were built at the same time, and that certainly figured into the plans for the ship channel." That would not be a rivalry — despite any excavation claims — but a realization that with the simultaneous completion of the Panama Canal, a large, modern world-scale port with some relative removal from the coast for storm shelter was likely to be a center of capitalism for the common good. **$**

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UNFORGIVEN

AMERICA'S CONTROVERSIAL ATTEMPT TO COLLECT REPAYMENT OF DEBT FROM ALLIED NATIONS FOLLOWING THE GREAT WAR

By Michael A. Martorelli

Beginning in April 1917, even before sending troops to fight Germany and the Central Powers, the United States government began lending billions of dollars to Great Britain, France and other allies to finance their war efforts. At the end of the Great War, the United States emerged as the world's leading creditor nation. In the decade following the November 1918 Armistice, many European governments canceled war-related debt obligations made to each other; but neither congressional leaders nor a series of US presidents agreed to any such cancellations. British and French officials were particularly displeased by the attitude of the United States towards its erstwhile European allies.

Making the Loans

Allied countries fighting against Germany and the Central Powers began borrowing funds from American banks as early as 1915. From September of that year until April 1917, several nations borrowed more than $1.6 billion from those institutions. However, the costs of the war were staggering, requiring the participants to seek other sources of loans. Eventually they turned to the US government. Immediately after declaring war on Germany in April 1917, Congress passed the first of six Liberty Bond Acts. It called for selling $5 billion worth of bonds to the public, and for lending $3 billion of the proceeds to various allies. Some government officials called for "gifting" the money to France, in exchange for its financial help during the American Revolution. Others called for waiving any interest on loans to that country. But the administration of President Woodrow Wilson decided that the terms of all loans must call for their eventual repayment and for the payment of an interest rate of 5%.

By March 1919, the United States had loaned more than $11 billion to 20 countries; almost three-quarters of that total had been loaned to Great Britain ($4.7 billion) and France ($3.8 billion). About $7.1 billion had been loaned during the war and allocated primarily to the purchase of munitions. Another $3.2 billion had been loaned after November 1918 and had been used for relief and reconstruction efforts, to pay interest on loans taken out before 1917 and to stabilize the value of the British pound and French franc. The loans were technically payable on demand, but Treasury Department officials assured their European counterparts that the country had no intention of calling the loans until long after the ending of all hostilities.

Initial Attempts to Set the Repayment Terms

Ever since 1914, Great Britain and France had been lending money to smaller allied countries. The borrowers understood they were incurring financial obligations that eventually would have to be satisfied. As early as December 1917, those two lenders began considering how the unprecedented level of war-related physical and economic destruction would strain the capabilities of their (mostly) European debtors to repay their loans. French Minister of Finance Louis-Lucien Klotz and British Chancellor of the Exchequer Andrew Bonar Law suggested to Assistant Secretary of the Treasury Oscar Crosby that those three allied lenders consider forgiving some portion of their inter-governmental war debts, since they had all been engaged together in prosecuting the war. Crosby disavowed his authority to discuss the issue.

Immediately after the signing of the November 1918 Armistice, officials from France and Great Britain again began suggesting that the Allied countries should discuss the potential pooling and/or cancellation of their inter-governmental war debts. They thought the United States (by far the largest creditor nation) should cancel many of its loans, suggesting the funds had been used to support the legitimate war expenditures of all Allied governments. President Wilson and Treasury Secretary William Gibbs McAdoo rejected this idea, asserting that the administration did not have the power to cancel those debts and suspecting that Congress would not approve of such an action. Moreover, they regarded the debts as legitimate financial transactions with terms that had to be enforced, not charitable contributions or the country's fair share of expenditures needed to prosecute the war.

As the Paris Peace Conference opened in January 1919, French High Commissioner Eduoard de Billy wrote the new Treasury Secretary Carter Glass proposing that the questions of German war reparations and inter-allied loans be added to the agenda. On instructions from President Wilson, Secretary Glass informed de Billy that the United States had no interest in reparations and that it would only discuss inter-allied debts after the conclusion of that conference. During the next few months, administration officials rejected at least two other debt-cancellation proposals. However, the United States was quite aware of many foreign governments' consternation over the terms of their debts.

In May, President Wilson's economic advisors suggested that, in light of the bleak economic situation throughout Europe, the United States should consider suspending the interest payments on the loans to its allies for two or three years. In September, the president authorized the Treasury Department to take that action. Soon after, Treasury Secretary Glass assured Congress that the administration had no intention of forgiving any debts, but that it was trying to respond

to the overwhelming financial pressures being faced by its debtors.

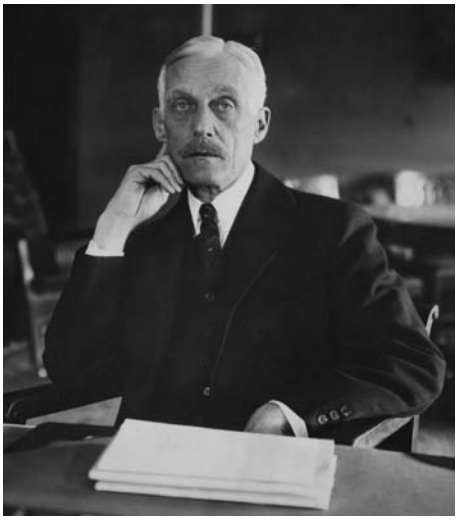
During the Paris Peace Conference, many allies discussed among themselves the cancellation of each other's war debts. They envisioned war reparations from Germany as the potential source of much of the funding needed to support the repayment of any inter-allied debts that were not cancelled. Great Britain and France were particularly insistent that the receipt of such reparations would be a necessary pre-condition to their own ability to repay their debts. The United States continued to show no interest in discussing German war reparations and remained unwilling to discuss any cancellation of its inter-allied debts. Without President Wilson's cooperation, the Treaty of Versailles left both questions unresolved, although a provision of that June 1919 treaty did call for the early 1921 meeting of a Reparations Commission to determine the amount of the fines to be levied on Germany and the Central Powers.

In February 1920, the British presented the United States with yet another proposal for a general settlement of all inter-allied debts. Chancellor of the Exchequer Austen Chamberlain wrote Assistant Treasury Secretary Russell Leffingwell about the fear that such debts were hampering the efforts of most European governments to recover from the war's effects. He noted that Great Britain had forgiven some 85% of the loans it had made to its allies after the conclusion of the Napoleonic wars a century earlier. From 1914 to 1918, Great Britain had loaned a total of $7 billion to 11 Allied countries. But His Majesty's government was prepared to consider forgiving some of those debts, and to moderate its demands for German war reparations, if the US government would consider forgiving some of its inter-governmental debts. In rejecting this suggestion, US Secretary of State Robert Lansing noted once again the contractual nature of the obligations, and the moral and legal differences between those loans and the punitive German reparations.

In August, Prime Minister Lloyd George tried once again to convince President Wilson to accept the concept of "parallel liquidation," whereby the payment of debts to the United States would be linked to the receipt of German reparations, i.e. Great Britain, France and others would repay their debts to the United States with the funds they were receiving from German reparations. In his November reply, the president again noted his lack of authority to make any changes in the loan agreements and repeated all the arguments against debt forgiveness the United States had been making during the past two years. Thus, 1920 ended with the issue of debt payments still unresolved.

The Foreign Debt Commission

Technically, the loans the United States made to its allies were payable on demand. Given the weak economic conditions that prevailed throughout Europe in the immediate postwar years, administration officials did not think it wise or necessary to insist on quick repayment. Indeed, many American businessmen suggested that forgiving those loans, or at least the interest due on them, would help Europe recover; and a stronger European economy would also benefit the United States.



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Secretary of the Treasury Andrew Mellon's request to restructure the allied war loans led Congress to create the World War Foreign Debt Commission.

Americans elected Warren Harding as president in November 1920. This inoffensive compromise candidate promised "a return to normalcy," a concept that included a strong economy and a disengagement from European affairs. His administration was sympathetic to the business community's desire for some compromise on the subject of inter-allied war debts.

In June 1921, Secretary of the Treasury Secretary Andrew Mellon asked Congress for the authorization to restructure those loans by lowering their interest rates and extending their maturity dates. After eight months of political wrangling, Congress responded to Mellon's request by creating the World War Foreign Debt Commission and empowering that five-man group (later expanded to eight) to adjust the terms of the loans the country had made to its allies. The enabling legislation instructed the Commission members to arrange to collect the loans from all 20 debtor nations within 25 years, and to charge an interest rate no lower than 4.25%. It forbade the cancellation of any part of any debtor's loan. Immediately after the publication of those terms, the French press began protesting the harshness of the US government's attitude towards its foreign debtors.

President Harding's appointees to the Debt Commission were more willing than congressional leaders to show some charity to the country's wartime allies. During 1921, several had urged leniency and generosity towards the debtor nations. At its first meeting in April 1922, the Commission notified all debtor countries that it was prepared to consider proposals for the settlement or refunding of their loans. During the rest of that year, its members had preliminary discussions with many debtors' representatives.

They reached the first "agreement in principle" (with Great Britain) in February 1923. That agreement was formalized in June, following some acrimonious discussions in London and Washington. Since it included terms that did not comport with the strict guidelines under which the Commission operated, it had to be approved by both houses of Congress. Between May 1923 and May 1926, and following the precedent established while crafting that pact, the Commission was able to negotiate debt restructurings with 12 other countries. None of them conformed precisely to the Commission's strict limitations, since they extended the payment dates beyond 25 years and called for interest rates lower than 4.25%; but all of them were approved by Congress. Meanwhile, the Treasury Department made separate settlements with three countries and determined it could not collect the loans made to four others. Restructuring the loans made to the two largest debtors (Great Britain and France) was neither quick nor easy.

Dealing with Great Britain

The Debt Commission first met with representatives of Great Britain in January 1923. During the preceding year, British officials had » *continued on page 36*

Plundered by Harpies

An Early History of High-Speed Trading



Museum of American Finance

Uniformed NYSE trading floor clerks gathered around a stock ticker, ca. 1915.

By Bob Pisani

On January 28, 1790, Representative James Jackson of Georgia rose and spoke in the then very-young House of Representatives, meeting in New York City. His purpose: to denounce high-speed traders.

"Three vessels, sir," Rep. Jackson thundered, "have sailed within a fortnight from this port, freighted for speculation; they are intended to purchase up the State and other securities in the hands of the uninformed…"

Jackson railed against these men, calling them "rapacious wolves…preying upon the misfortunes of their fellowmen, taking an undue advantage of their necessities."

What terrible crime did these men commit? Murder? Treason?

Hardly. Jackson and his fellow Congressmen were debating a proposal by Secretary of the Treasury Alexander Hamilton that the then-new US government should assume the old debts that the states and the Continental Congress incurred during the Revolution, a proposal that became known as the Funding Act of 1790.

Traders who had heard of the deliberations immediately chartered fast-moving boats to front-run messengers and began buying up the old debt, reasoning correctly that passage of the Act would raise the market value of the old debt, which was trading in some cases at 10% or less of its face value.

Jackson was outraged; he demanded that Congress take action to "save the distant inhabitants from being plundered by these harpies." The "distant inhabitants" Jackson was referring to were his constituents in Georgia; although, in a sense, we are Rep. Jackson's distant inhabitants, still praying to be saved from the harpies.

Railing against informational advantages that "speculators" possessed was a common feature of American life from the founding of the country right up to the present day. Today, many complain that "high-frequency traders" who employ mathematical algorithms have unfair advantages over those whose algorithms are not as good, or who have trading systems that are faster than theirs.

From the outset, there was a deep and abiding suspicion of the broker, who, for a price, was willing to buy or sell your stock, bond or commodity. It was a suspicion that these middlemen knew something that buyers and sellers did not.

True or not, these complaints underscore a larger historical fact: any technology that increased the speed of information flow was immediately adopted by the trading community in both Europe and the United States. Traders have employed every known conveyance to trade faster and cheaper. They were among the earliest adopters of faster boats, faster stagecoaches and private horse expresses. The trading of securities was among the very first uses of the telegraph.

The adoption of these high-speed trading techniques had two characteristics: 1) they greatly reduced the price differences between markets, and 2) those who were slower to adopt bitterly complained that the new technologies offered unfair advantages to the participants.

Then, as now, the buying and selling public — and the government — were desperate to keep up. Congress established the US Postal Service in 1792 specifically for the "conveyance of information" into "every part of the Union." By establishing low rates for the transmission of newspapers that contained market-sensitive information, it was hoped that citizens could be quickly apprised of market-moving events and stay ahead of the "harpies."

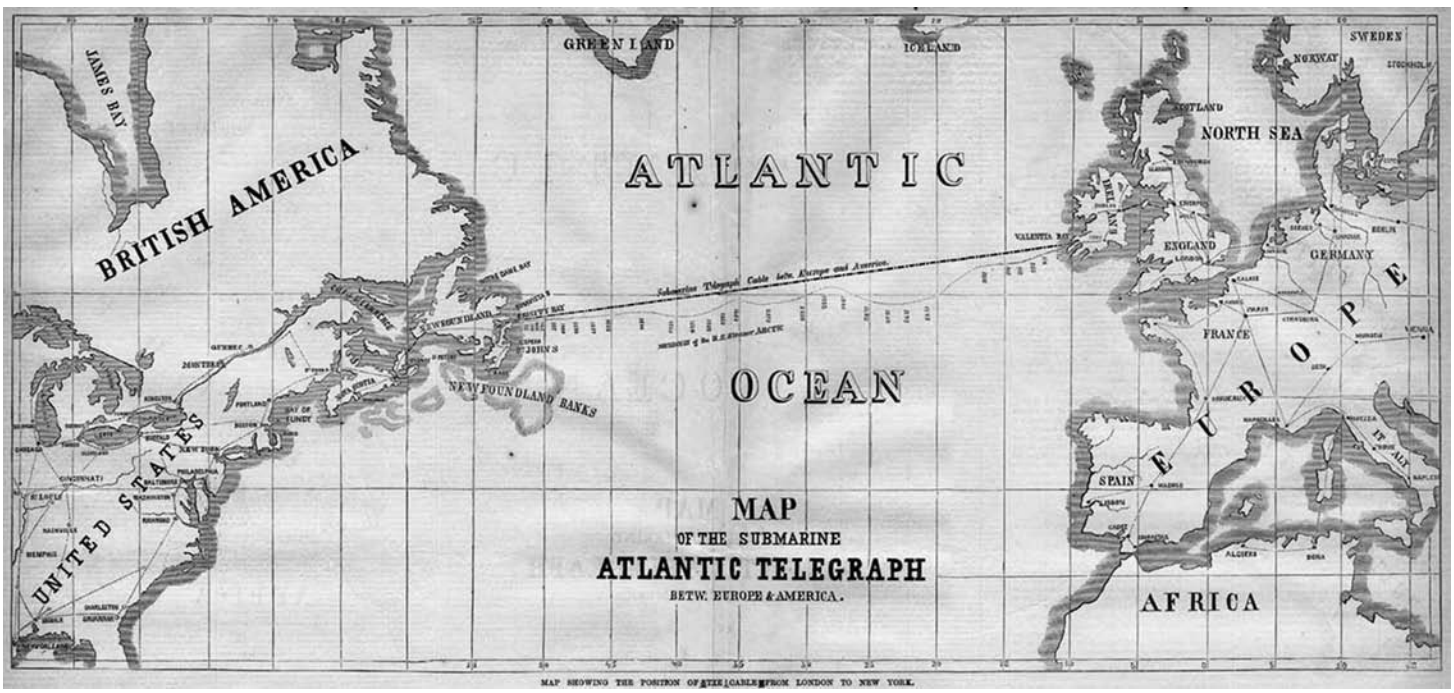
But speculators were far quicker than newspapers. In 1817, when a ship arrived in New York from London with news that caused a sharp rise in stocks, three speculators jumped on a stagecoach for Philadelphia to buy up stocks. Thanks to greatly improved highways, the time to travel between New York and Philadelphia had been cut to under two days, creating a lively arbitrage in stock trading between the Philadelphia Stock Exchange (founded 1790) and the early version of the New York Stock Exchange (founded 1792).

When the stagecoach broke down, they hired their own coach and arrived in Philadelphia before the broken coach arrived with the news. They immediately bought stock, and when the mail arrived the prices jumped in value. Those left out insinuated that the speculators had paid the stagecoach driver to delay the mail.

Traders quickly set up networks of speedy "private expresses" along the newly-created networks of turnpikes and expanded postal roads, from New York to New Orleans. By 1825, Postmaster General John McLean, outraged by speculation in the cotton market, attempted to convince Congress to shut down these high-speed trading networks and set up a government system that conveyed newspapers at the same speed as letters to thwart speculators. "On all the principles of fair dealing," McLean wrote, "the holder of property should be apprised of if its value before he parts with it…To purchase an article at one-half or two-thirds of its value, which is known to the buyer, but carefully concealed from the seller, is in opposition both to the principles of law and sound morality."

So serious was the government's attempt to shut down high-speed couriers that the US Post Office operated a high-speed horse express from 1836 to 1839 linking New York and New Orleans that transmitted news reports to journalists on lightweight tissue paper rather than far more costly newspapers.

Traders, ever desperate for a trading edge, soon cut the time gap dramatically — they cut out the horse and stagecoach! In the late 1830s, Philadelphia broker William C. Bridges operated a private signal station between New York and Philadelphia which disseminated stock market news to him and his backers (and to no one else). The signals were transmitted through an "optical telegraph," which consisted of a series of boards on a pole, mounted on hills that could be seen by a telescope. Reports indicated that it could transmit stock information from New York to Philadelphia in anywhere from 10



Map showing the location of the transatlantic cable between New York and London.

to 30 minutes. In the 1830s that was high-speed trading!

Not surprisingly, there were complaints from New York speculators not part of the scheme, who had up to this time enjoyed a substantial trading advantage. The locals in Philadelphia were not happy either. When the system was shut down after the arrival of the telegraph in 1846, a local newspaper account recounted that "many mysterious movements in the Philadelphia stock and produce market were laid at the door of the speculators who worked the telegraph. No doubt the speculators paid them well."

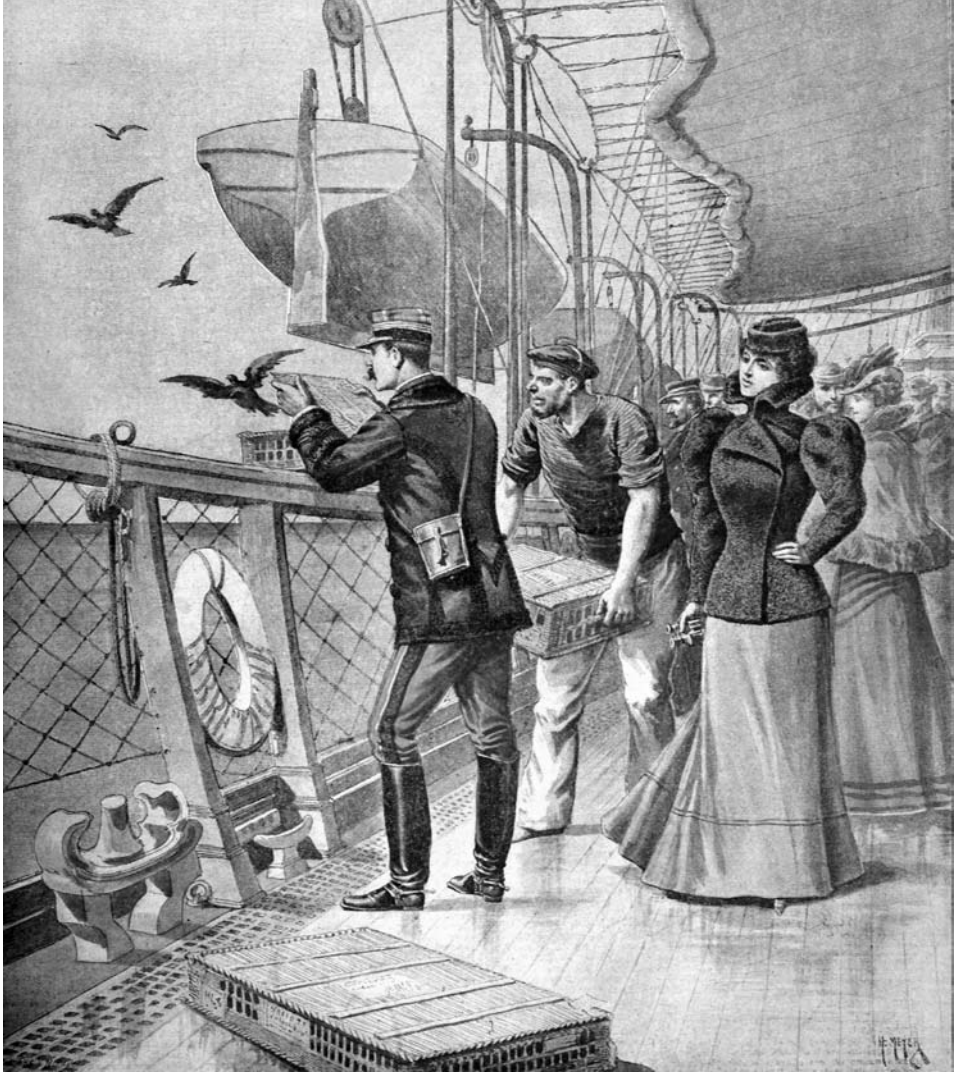
No doubt. Unfortunately, the "organized" trading community did little to foster transparency. In the early days of its existence, the NYSE (then known as the New York Stock and Exchange Board) barred the public from listening in on its trading sessions (sessions would not be open to the public until 1869). Competing traders (curb traders, who literally operated outside) who wanted to trade off the NYSE's trades were furious that they could not get proximity to the exchange. In 1837, the NYSE discovered that the curb traders had drilled a hole in the brick wall of its building in order to eavesdrop on the trading.

Just as the public was debating how to outwit high-speed horses, a new technology came on the scene that would transform trading into a truly high-speed endeavor: the telegraph, which came into use after 1844.

It was the greatest invention of its age. Newspapers took time to get out and for the most part operated only at fixed intervals. But the telegraph operated at all hours and could be used for private communications.

It was a high-speed trader's dream come true. The first customers were stock brokers and lottery speculators. On March 3, 1846, the *New York Herald* reported that "certain parties in New York and Philadelphia were employing the telegraph for speculating in stocks."

Predictably, there was great indignation at the use of the telegraph to transmit "secret intelligence." Several early inventors of the telegraph were persuaded to abandon their endeavors when warned that they could be prosecuted for circulating information in advance of the mail. The principal inventor of the telegraph, Samuel F.B. Morse, was in favor of a hybrid public/private takeover of the entire telegraph business specifically to guard against speculative abuse.



© Chris Hellier/Corbis

Communications experiment using carrier pigeons, 1898.

It was all for naught. Congress ultimately declined to take over the telegraph system, partly because competition for market-moving information and the limited wires space then available was intense. That competition emerged not only among traders but among their biggest competitor: the press.

The early 1800s saw the birth of the modern newspaper industry, and much of the purpose of those early papers was to get financial news out more quickly. James Gordon Bennett Sr., who in 1835 founded the *New York Herald*, one of the country's first "penny" newspapers, emphasized that the emerging press would break the information monopoly of the few: "Speculators should not have the advantage of earlier news than the public at large," he proclaimed.

Suddenly, newspapers had boats. And optical telegraphs. The *Journal of Commerce*, founded in 1827 to cater to the financial community, kept deepwater boats to meet ships arriving from abroad. An optical telegraph system similar to the private one operating between Philadelphia and New York operated between Sandy Hook, New Jersey, and New York City to inform the editors when ships were arriving.

The *Journal of Commerce* and its rival, *The Courier and Enquirer*, even established rival pony expresses that ran between New York and Philadelphia, and, later, to Washington. Even the pigeons were dragged into the competition: one group of penny newspaper owners paid $2,000 for a fleet of carrier pigeons to send news between Philadelphia, Washington and Baltimore.

Traders, however, had plenty of help, for a price. One news entrepreneur, Daniel C. Craig, made a fortune selling information on European news to traders. Using a combination of pigeons and express couriers, he got news from European steamers which had just sailed into Halifax harbor in Nova Scotia to Boston before anyone

else. The information was then sent to New York via telegraph.

Craig was so effective in gathering information ahead of others he was later hired by the newly-formed New York Associated Press. The press was apoplectic about traders and the agents who supplied them with information. There was particular anger directed against telegraph operators who were believed to have close relationships with traders; editorials railed against the telegraph's potential for falling "in the hands of bad men."

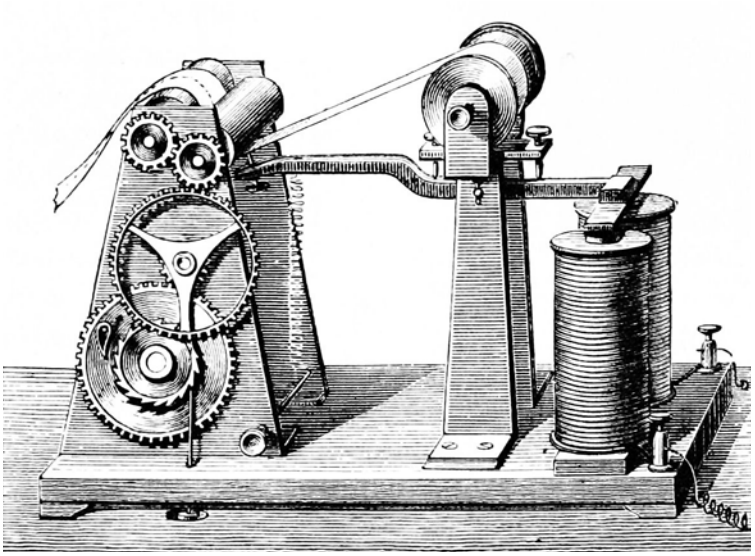
Receiving information first was so valuable that some speculators, at times in cahoots with telegraph operators, were willing to cut the telegraph wire after the news had been received! Because telegraph operators were among the first to receive tradable news, some operators cut out the speculators altogether and went into business for themselves. This continued for decades: when the Civil War broke out, several Western Union employees made a fortune in the gold markets by leveraging their advance knowledge of war news.

Forty years later, the telegraph was still a stock speculators' realm. In 1887 the president of Western Union said 87% of the company's revenue came from stock and commodity speculators, and from racetrack gamblers.

Getting a faster boat across the Atlantic was even more lucrative for traders. In the middle of the 19th century, it took eight days to cross the Atlantic, and any person who could get important news across the ocean more quickly could profit from it. In one extreme example, when it became known in New York City in 1865 that the South had lost the war, financier Jim Fisk chartered several ships that were faster than the mail ships then in use and sailed them to London with orders to his brokers to sell short Confederate bonds. When the news became known in London that the South had lost, the price of the bonds went to zero, and Fisk of course made a fortune.

Just as the telegraph had been eagerly adopted by stock traders in the United States, stock trading and other commercial uses were among the first uses of the transatlantic cable. The first successful cable came into use in 1866 between New York and London and greatly reduced the information advantages that some traders had previously enjoyed; brokers could now telegraph an order to London and receive confirmation within five minutes. Price differences between securities soon began to narrow.

The stock ticker, introduced in 1867, was the next great electronic technology that was immediately adopted by the trading community. Prior to its introduction, stock trades were typically done by "pad shovers" — boys who ran back and forth between the trading floor and the offices of brokerage firms. It was an enormous advance over the telegraph for several reasons: 1) traders no longer needed to be physically present on exchange floors; 2) it reduced transaction costs; 3) it enabled the dissemination of continuous, real time information; and 4) it cut out pesky intermediaries like telegraph operators and newspaper editors. Not surprisingly, journalists and newspaper editors began to worry that the ticker might put them out of the lucrative business of financial news.



Drawing of the Morse telegraph that appeared in *Popular Science Monthly,* ca. 1872–1873.

Thomas Edison did not invent the ticker, but he made several crucial improvements, including the invention in 1873 of the quadruplex, which allowed four messages to travel simultaneously over one wire. Western Union put this excess capacity to good use: they leased the lines to private networks controlled by Wall Street firms. The firms were connected to their branch offices by these private telegraphs in Boston and Philadelphia by 1879, and to Chicago by 1881. These private wires were faster than the "public" telegram. They were also more reliable and provided confidentiality.

And Wall Street gladly paid up, because getting access to trading data as fast as possible was, as always, crucial to profitable trading: by 1894, brokers at the Boston Stock Exchange knew of trades at the NYSE within 30 seconds.

The stock ticker also initiated a new wave of stock market speculation, this time led by working class investors who began speculating through the newly-created bucket shops, which had also hooked up to ticker machines. Professional traders, who had heretofore enjoyed an enormous information advantage, bitterly complained: "indiscriminate distribution of stock quotations to every liquor-saloon and other places has done much to interfere with business," New York broker John T. Denney said in 1889. "Any person could step in a saloon and see the quotations."

Though bucket shops were mostly scams (there was no actual transfer of stock, so "investors" were merely betting against the bucket shop operator), many paid top dollar for fast telegraph services; in 1887 the NYSE discovered that one Chicago bucket shop was getting stock quotations several minutes earlier than the "regular" ticker service, thanks to assistance from Western Union.

It went on like this, through the development of the specialist system in the 1860s, the invention of the telephone (first tested by Bell in 1876; there was a phone on the NYSE floor by 1878), pneumatic tubes shortly thereafter, the computer in the 1950s, computer-readable cards in the 1960s, the early development of electronic trading when the Nasdaq began operation in 1971 and algorithmic trading in the 1990s. It was the same argument: some were getting information ahead of others, and others were able to execute trades because they had a faster boat/horse/carriage/telegraph line/computer link/algorithm.



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Man using the new "high speed" stock ticker, 1930. According to the original caption, "Western Union has ordered 10,000 [tickers] and has begun installation in brokers' offices throughout the country. The company is spending $4.5 million in an effort to speed up stock quotation service… to keep pace with the new era of six or eight million share trading days on the stock exchange."

The public and government response to the traders' "need for speed" varied, but one factor remained fairly constant: the informational advantages of any new technologies seem to have diminished over time. From the very beginning, astute observers recognized this fact.

Let's go back to Representative Jackson and the debates in 1790 that centered on whether Congress should take action to outlaw "speculation" (men hiring fast boats). When several Congressmen objected, arguing it would be impossible to prevent such activity, and always had been, Jackson countered by saying he knew full well that there was "speculation in the funds of every nation possessed of public debt," but this was different: these were people trading on information they had, but that others did not. This, he implied, was dishonorable, and just plain wrong.

One Representative, Elias Boudinot of New Jersey, rose and agreed that while speculation had risen to "an alarming height," he concluded that the only measure that would be effective to stop it was "appreciating the public debt, 'til the evidence in the hands of the creditors came to their proper value."

Boudinot was arguing that the only way out was to recognize the value of the debt had increased and implied that wider dissemination of information — more transparency — was the most effective disinfectant. Boudinot implicitly conceded that the first movers of any new technology (faster boats, in this case) had an initial advantage. Yet the advantages conferred were fleeting as others adopted the new technologies. That was certainly the case with the telegraph and the stock ticker.

And whatever happened to that debate about the debt and the "harpies" seeking to profit from it? The bill was passed in 1790, the US government assumed the debt of the Continental Congress and the states, and the new government issued bonds.

Immediately, a brisk trade in those bonds ensued among merchants and auctioneers, the very "harpies" Representative Jackson railed against. This business proved to be so lucrative that some began to specialize in trading those very same securities. Two years later, on May 17, 1792, 24 brokers gathered in front of a buttonwood tree on Wall Street and attempted to form a quasi-monopoly in trading that debt and what few stocks were available to trade by promising to "give preference to each other in our Negotiations." That group became what is now known as the New York Stock Exchange. **$**

Bob Pisani is Stocks Correspondent for CNBC.

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ACE GREENBERG

Tribute to a Wall Street Legend

By Bart Ward

From humble beginnings as the son of a clothier in Oklahoma City, Alan "Ace" Greenberg started his career on Wall Street as a clerk at Bear Stearns Companies, Inc. in 1949. He ended up running the show by 1978 after the legendary Salim L. "Cy" Lewis died. After four decades as head of Bear, James "Jimmy" Cayne took over from Greenberg in 1993.

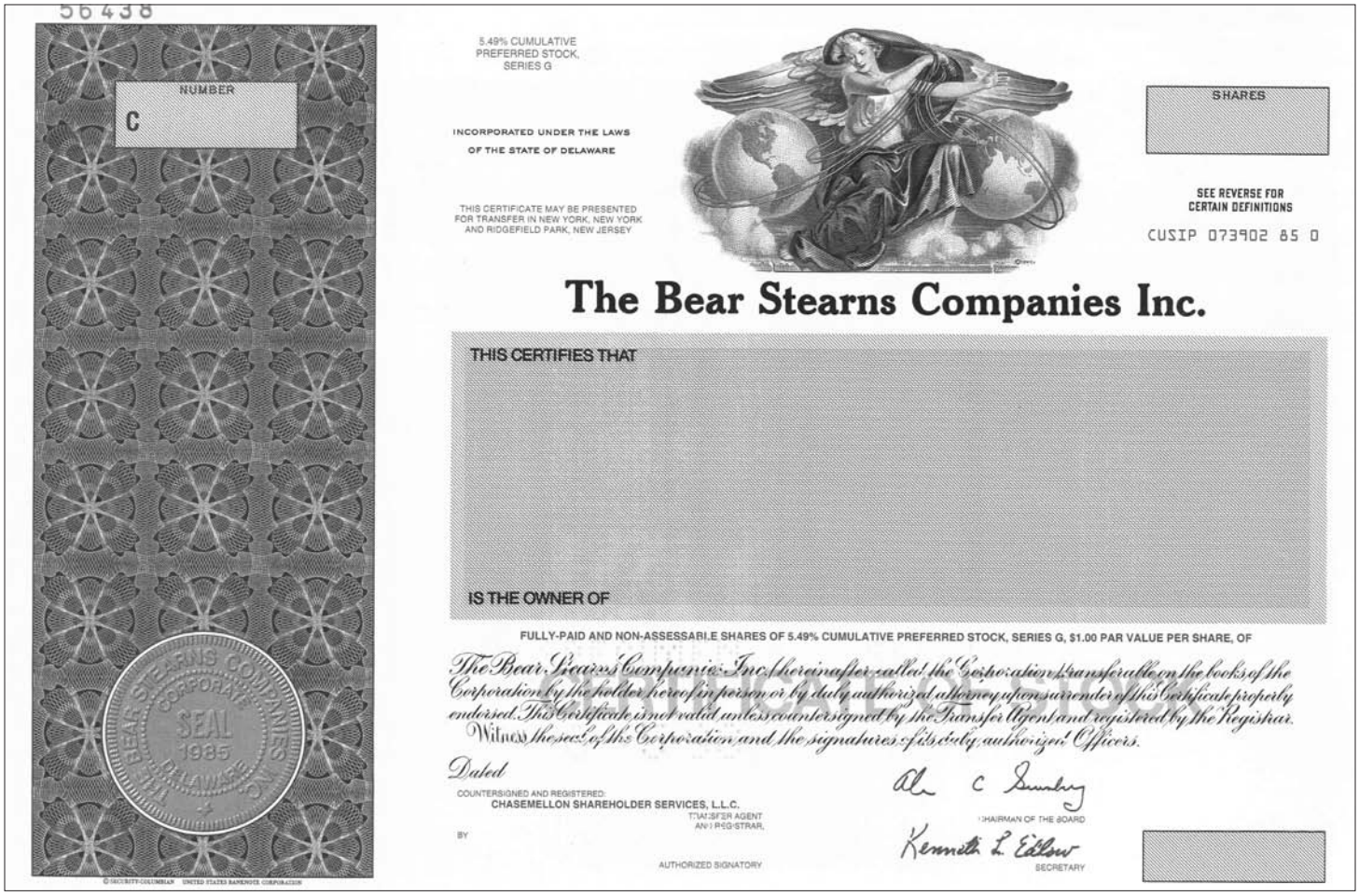
Known as a tough, aggressively determined and ambitious Wall Street chieftain of a scrappy firm, Greenberg built what Kate Kelly describes in her 2009 book, *Street Fighters,* as "…the toughest firm on Wall Street." Greenberg died on July 25, 2014 at age 86.

In *King of the Club,* author Charles Gasparino describes Greenberg as "one of the most powerful players on Wall Street and one of its best traders." Greenberg was notorious for cutting losses in the market. Few on Wall Street adhered to the old adage, "cut your losses, let profits ride," as strictly as Greenberg did. In an article written shortly after Greenberg's death, the *Wall Street Journal* noted, "Mr. Greenberg, a hard-charging trader and sharp-tongued manager, helped turn Bear Stearns, Cos. into one of the world's

Bear Stearns chief Ace Greenberg at his desk, 1980.

"I won't hold an M.B.A. against you; but I prefer Poor, Smart, and a Desire [PSD] to be rich."

Alan "Ace" Greenberg, referencing the kind of people he liked to hire.



Museum of American Finance

Bear Stearns specimen stock certificate with Alan "Ace" Greenberg as chairman of the board.

biggest — and riskiest — securities firms. In a throwback to an earlier time in the financial world, he for years ran the firm from a raised desk on the bustling trading floor with an iron fist."

For its part, Bear was founded as an equity trading house by Joseph Ainslee Bear, Robert B. Stearns and Harold C. Mayer, Sr. in May of 1923. The firm was known for surviving the Great Crash of 1929 intact. It opened its first international office in Amsterdam in 1955, and later opened offices in Geneva, Paris, London, Hong Kong and Tokyo. By 1965 it had an office in San Francisco and by 1973 had offices in Los Angeles, Dallas, Atlanta and Boston.

In 1985 the company went public under Greenberg's tenure. According to *International Directory of Company Histories*, "Bear Stearns's willingness to take risks pushed it into the forefront of corporate takeover activity. The firm was described as a 'breeding ground' for corporate takeover attempts, and as masterful at disguising takeover maneuvers. In some instances, however, Bear Stearns's aggressiveness earned it an unsavory reputation."

Gasparino says that Bear was, "the quintessential Wall Street trading house, where top producers are rewarded handsomely while those who fail to perform are shown the door…An Ivy league degree and WASPy-sounding last name might get you an interview at Morgan Stanley and Goldman, but at Bear, they're a sign of weakness. The Bear loves competitors…"

Greenberg was a very different kind Wall Street chief, especially in his management of risk. He constantly battled with Lewis, so much so that it rocked the firm. This was not unusual in the culture of Bear, where partners often scrapped with one another in their rise to the top. A former partner told the *Journal* in 1982, "You could put him [Greenberg] in an empty room and lock him up, and he'd think of some way to make money." The *Journal* went on: "Mr. Greenberg's aversion to long meetings may be one factor that has kept Bear Stearns away from the merger table despite the waves of consolidation in the financial business, 'We've never talked to anybody,' he says, 'and we don't want to.'"

Greenberg was also an avid bridge player, and that is in part why he brought Cayne — a notorious bridge player, even better than Greenberg — into the firm. Greenberg also enjoyed performing magic tricks, and Warren Buffet once wrote, "Ace Greenberg does almost everything better than I do: bridge, magic tricks, dog training, arbitrage — all of the important things in life."

In 2008 Bear was at the center of the financial crisis and was absorbed by JPMorgan Chase. By the time the company collapsed in March 2008, Greenberg was serving as chairman of its executive committee. In his 2009 book, *The Sellout*, Gasparino wrote, "the House That Ace Built, that Jimmy Cayne had remade, and

that Alan Schwartz had tried to save was gone…Jimmy Cayne, who once swaggered around Wall Street as one of its most powerful figures, was now unemployed."

Greenberg moved on to JPMorgan as vice chairman *emeritus*, and he continued to come into the office until his last days. In 2010 he authored *The Rise and Fall of Bear Stearns,* which received accolades from the likes of Buffett, Tom Brokaw, T. Boone Pickens and Kenneth Langone.

JPMorgan CEO Jamie Dimon released a statement after Greenberg's death saying, "JPMorgan is no doubt a better place for having had Ace as a part of it, and while there will never be another Ace Greenberg, the example he set will certainly live on through all of us that had the opportunity to learn from him."

Steve Forbes said, "Ace Greenberg was the kind of person all too rare in any era: a doer, a builder and a courageous, disciplined and ethical risk-taker."

And Richard Grasso, former chairman of the NYSE, said, "Long before I became chairman, I got to know Ace when I headed the Department of Stock List. He was a true gentleman, and made those who only dreamed of reaching his level feel important. He always called me "kid," which was a source of great pride when I became chairman. The industry has lost a great leader whose presence and great judgment will be solely missed." **$**

Bart Ward is CEO of the Investment Advisory firm of Ward & Company, Ltd. Since 1993 he has written the weekly Wall Street history and market-oriented column, "The Corner." He holds a degree in history from UCLA. This article was adapted from the July 31, 2014 article on Greenberg's life in "The Corner."

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въ ВѢНѢ—австро-венгерскими кронами: въ Англо-Австрійск. Банкѣ, Вѣнск. союзн. Банкѣ, Имп.-Кор. Австрійск. прив. земельн. ганн. Кредитн. Обществѣ, Имп.-Кор. Австрійск. прив. Торг.-пром. Кред. Обществѣ, Нижне-австрійск. Учетн. Обществѣ, Имп.-Кор. Австрійскомъ прив. Земскомъ Банкѣ;

въ АМСТЕРДАМѢ—голл. гульденами, у гг. Гопе и К°, въ Отдѣл. Парижско-Нидерландск. Банка, у гг. Липманъ, Розенталь и К°;

въ БЕРЛИНѢ—имперскими германскими марками: у гг. Мендельсонъ и К°, г. С. Байхредеръ, въ Дирекціи Учетнаго Общества, въ Берлинскомъ Торговомъ Обществѣ.

Уплата капитала по облигаціямъ, вышедшимъ въ тиражъ или подлежащимъ выкупу, производится въ тѣхъ же мѣстахъ и въ тѣхъ же валютахъ, какъ и оплата купоновъ, по предъявленіи самой облигаціи съ талономъ и всѣми купонами, срокъ коихъ наступитъ послѣ срока уплаты капитала; сумма недостающихъ купоновъ будетъ удержана при выдачѣ капитала по облигаціямъ.

Въ случаѣ производства досрочнаго погашенія части займа, нумера досрочно погашенныхъ облигацій изъемлются при послѣдующихъ тиражахъ наравнѣ съ нумерами оставшихся въ обращеніи облигацій.

Каждая облигація снабжена 20 полугодовыми купонами и талономъ для полученія новаго купоннаго листа на дальнѣйшій срокъ.

Управляющій Государства Коммиссіею Погашенія Долговъ П. Ефимовъ

Бухгалтеръ

Постановленіе изъ Именного ВЫСОЧАЙШАГО Указа Министру Финансовъ отъ 4 Апрѣля 1906 г.

1. Согласно представленію вашему, въ Комитетѣ Финансовъ разсмотрѣнному, признали Мы нынѣ полезнымъ выпустить 5% государственный заемъ на нарицательный капиталъ 843.750.000 рублей =2.250.000.000 франковъ=1.818.000.000 германскихъ марокъ =1.075.500.000 голландскихъ гульденовъ=89.325.000 фунтовъ стерлинговъ =2.133.000.000 австро-венгерскихъ кронъ на слѣдующихъ основаніяхъ:

2. Заемъ сей вносится въ Государственную долговую книгу подъ именованіемъ: „Россійскій Государственный 5% заемъ 1906 года".

3. Облигаціи сего займа выпускаются именныя и на предъявителя достоинствомъ въ 500, 2500 и 5000 франковъ, считая каждые 500 франковъ=187 рублямъ 50 копѣйкамъ=404 имперскимъ германскимъ маркамъ=239 голландскимъ гульденамъ=19 фунтамъ стерлинговъ 17 шиллингамъ=474 австро-венгерскимъ кронамъ.

4. Правила относительно именныхъ облигацій, ихъ перехода отъ одного лица къ другому, ихъ обмѣна на предъявительскія и обратно имѣютъ быть утверждены вами.

5. Размѣръ ежегоднаго по облигаціямъ дохода опредѣляется въ 5% годовыхъ, уплачиваемыхъ полугодово; теченіе процентовъ начинается съ 18 Апрѣля/1 Мая 1906 года.

6. Весь заемъ будетъ погашенъ не позже 18 Апрѣля/1 Мая 1956 года. Погашеніе будетъ производиться путемъ ежегодныхъ тиражей. Тиражи будутъ происходить 19 Января/1 Февраля каждаго года, начиная съ 1917 года; капиталъ вышедшихъ въ тиражъ облигацій уплачивается въ слѣдующій за тиражемъ срокъ оплаты купоновъ; на погашеніе зачисляется ежегодно, начиная съ 1917 года, 0,92791612 % отъ нарицательнаго капитала займа, съ прибавленіемъ процентовъ на вышедшія въ тиражъ облигаціи.

6. До 18 Апрѣля/1 Мая 1916 года не будетъ приступлено къ выкупу, полному или частичному, или къ конверсіи настоящаго займа.

7. Уплату процентовъ и выдачу капитала по вышедшимъ въ тиражъ облигаціямъ производятся въ Россіи—рублями въ учрежденіяхъ Государственнаго Банка, во Франціи—франками, въ Голландіи—голландскими гульденами, въ Англіи—фунтами стерлинговъ и въ Австро-Венгріи—австро-венгерскими кронами, въ мѣстахъ, вами для сего назначенныхъ.

8. Купоны отъ облигацій сего займа сохраняютъ платежную силу въ теченіе десяти лѣтъ съ наступленія сроковъ ихъ оплаты, а тиражныя облигаціи—въ теченіе тридцати лѣтъ со срока выплаты по нимъ капитала.

9. Облигаціи и купоны сего займа освобождаются навсегда отъ всякихъ русскихъ налоговъ.

10. Облигаціи настоящаго займа помѣщаются чрезъ посредство избранныхъ вами для сего банкирскихъ домовъ и кредитныхъ установленій.

11. Права и преимущества, предоставляемыя по отношенію къ подписямъ на облигаціи настоящаго займа держателямъ 5%, обязательствъ Государственнаго Казначейства 1905 года (п. 7 Именного Высочайшаго Указа Министру Финансовъ отъ 29 Апрѣля 1905 года), опредѣляется вами.

12. Права и преимущества, предоставляемыя облигаціямъ и купонамъ настоящаго займа по отношенію къ пріему въ уплату таможенныхъ пошлинъ, а также въ обезпеченіе исполненія казенныхъ подрядовъ и платежей, причитающихся вамъ, опредѣляются вами при самомъ выпускѣ займа.

19 ф. ст. 17 шилл. 1906 474 АВ.-В. КР.

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UKRAINE AND RUSSIA

"YOU BREAK IT, YOU BOUGHT IT"

By Joseph Blocher and Mitu Gulati

The drama in Ukraine has occupied global headlines for many months now and — while there are occasional signs that things are calming down — the overall picture is not pretty. Most likely, Ukraine is going to lose large portions of its territory and populace to either Vladimir Putin's Russia or the separatist "New Russia." Partially as a result, it also faces economic ruin.

The other players in the drama bear their share of scars as well. Russia might have gained territory (Crimea) and a new political ally (the New Russia, if it materializes as a state), but it faces the prospect of serious sanctions from the West, impediments to future financial transactions and political isolation. The situation also presents serious problems for the West — the European Union, the United States and their other allies. Russia is a crucial trading partner for many of these countries, and imposing sanctions will therefore hit them hard.

To add to it, these nations can ill afford the increased military spending that is likely to result from the current tensions. After all, the Euro area has barely come out (it seems) of a deep sovereign debt crisis, and the United States is licking its wounds from hugely expensive military action in Iraq and Afghanistan. Most grim of all, beneath these currents of international politics lies an incalculable human cost. Hundreds of thousands of people have had to flee their homes, and thousands more have lost their lives. Unfortunately, more of this mayhem will occur before things are resolved.

Could international law have done something to avoid all this? To find an answer, we need to take a look at recent history.

How It Happened

A year ago, the Russian–Ukrainian relationship was radically different, at least at the government level. Russia was Ukraine's primary backer, giving it natural gas at subsidized rates, buying large amounts of Ukrainian bonds and paying rent for a large naval base in Crimea (Sevastopol). Even so, a substantial portion of the Ukrainian population sought closer ties with the EU and, by implication, weaker ties with Russia.

This did not please Russia. The Ukrainian government at the time was pro-Russian and tried to push against the EU sentiment. This in turn led to a public outcry, a little mischievous encouragement from the West (at least, in the view of the Kremlin) and a popular uprising that tossed out the old pro-Russian government, whose leader fled to Moscow.

Russia reacted badly, as tends to happen with jilted lovers — especially those who feel they have been subsidizing their partner for years. If Ukraine was going to run to the arms of the West, Russia at least wanted what it saw as its "stuff" back. That "stuff" included both citizens and sovereign territory.

While many Ukrainians wanted a closer alliance with the EU nations in the West, many other Ukrainians — who happened to be geographically concentrated in particular areas like Crimea — considered themselves ethnically Russian and had strong pro-Russian sentiments. The former regime had been good to them. And now, Putin was telling them that (a) he was concerned for their safety and well-being and (b) he would take care of them.

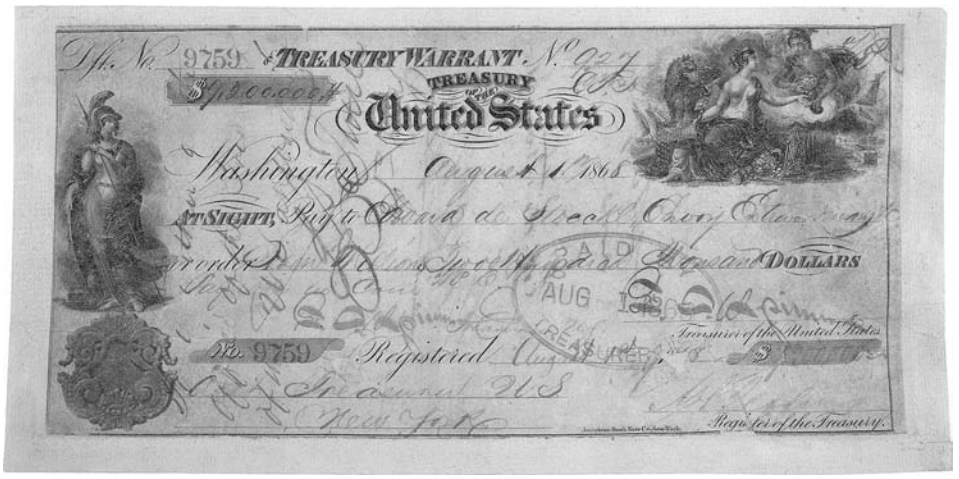
Indeed, he would take better care of them than the anti-Russian and soon-to-be-bankrupt Ukraine would. The result, helped along by Putin, was a move in multiple regions of Ukraine to separate from the mother nation. Crimea went in the blink of an eye. And now, regions in the Southeast, around Donetsk and Lugansk, want to be their own state or at least have "special status."

Financial Implications

Financially, the situation is a disaster for what remains of Ukraine. A few years ago, it was regularly able to issue billions of dollars of bonds on the international markets. But with no Russian subsidies or Russian purchasers of those bonds, lenders have disappeared. The International Monetary Fund (IMF) has given Ukraine a substantial aid package (in the vicinity of $17 billion), but it is already clear that Ukraine needs much more — according to recent IMF estimates, around $19 billion more.

That is going to be difficult for the IMF to provide, since it is not allowed to lend into unsustainable situations. And that, if the conflict continues, is where Ukraine is headed. In this adverse scenario, Ukraine's GDP is projected to drop by around 7% this year and 4% the next. To add to the

Defaulted Russian czarist bond, 1906.



Records of the Accounting Officers of the Department of the Treasury; Record Group 217; National Archives.

With this check, issued on August 1, 1868 in the amount of $7.2 million, the United States purchased Alaska from Russia. The check is made out to Edouard de Stoeckl, Russian minister to the United States, who negotiated the deal for Russia.

woes, Ukraine has lost Russia's subsidized natural gas and its rent payments for Sevastapol, and in fact Russia's Gazprom is now demanding $11.4 billion in payments on prior subsidies.

We have not even gotten to the worst parts. Ukraine's debt-to-GDP ratio a year ago was comfortably in the 40–45% range — respectable, particularly by European standards. But now, given that it is mired in a civil war and faced with the loss of major revenue-generating portions of its country, its debt-to-GDP might soon be in the 100% range. That kind of ratio is manageable for countries like the United States and Japan that can borrow at rates of near zero percent. But Ukraine has no one willing to lend to it, which means that it is in real danger of going into a full-scale sovereign default.

Historical Precedent and the Limits of International Law

Faced with this dire situation, Ukrainians might well ask whether there is some way of pushing some portion of this worsening financial obligation onto Russia. After all, from the Ukrainian perspective, Russia is the one that is misbehaving by inciting trouble and taking large chunks of Ukrainian territory. Moreover, much of Ukraine's current debt was incurred by the corrupt leadership of the old pro-Russian government.

Unfortunately for Ukraine, current international law and practice provide little relief. The most tempting doctrine to invoke is that of "odious debts," application of which would free Ukraine from many of its financial obligations. In a delightful bit of irony, the most famous formulation of this doctrine has Russian origins. (See sidebar, "A Doctrine of Odious Debts?," pg. 31.)

After the communists overthrew the Czar in 1917, they refused to repay his debts. Ten years later, a Russian émigré in Paris articulated an intellectual justification for this position, arguing that governments should not have to pay debts incurred by despots who spent the money in ways adverse to the interests of the people and whose creditors knew that this was going to happen.

The idea of odious debt has since been exhaustively debated and discussed in the academic literature, though only a few countries have endorsed it. Whether it even counts as a legal doctrine is, therefore, unclear. Assuming it does, the doctrine, at first glance, seems ready-made for the Ukrainian crisis. After all, large portions of the Ukrainian debt were incurred by a government that was likely quite corrupt, and where a significant portion of the lending was done by creditors (Russia and its banks and financial institutions) who were surely trying to prop up a regime because it served their interests.

But on closer examination, the facts as we know them may not satisfy the definition laid out above. First, it is not clear that — whatever his flaws — former President Yanukovych can accurately be described as a despot. After all, he had enough public support to get put in office in the first place. Second, it is unclear whether he stole so much that a recovery of the funds would make a dent in the many tens of billions that Ukraine borrowed and now owes. Third, it is unclear whether the creditors, even if they were Russian institutions, knew that he was stealing. In fact, if he was stealing, he was effectively stealing not only from the Ukrainian people, but also from the Russians. In other words, odious debt doctrine, though initially appealing, probably does not help Ukraine.

What about the fact that Russia has misbehaved by interfering in Ukraine's internal affairs? Isn't that illegal under international law and, if so, doesn't Russia have to give back the territory and maybe even pay compensation for its misdeeds? On one part of this at least, international law has definite rules. If Russia has been interfering with Ukraine's internal affairs and helping arm and encourage the separatist movements, that violates not only the fundamental international law principle of non-intervention in the internal affairs of a sister state, but also the UN Charter's command that member states refrain from the "threat or use of force against the territorial integrity" of any other state.

The fly in the ointment is that, though many in the West do not want to admit it, there are many people living in Ukraine who would rather be part of Russia. Indeed, thousands of them are demonstrating as much by leaving their homes in Ukraine and migrating to Russia. And that, in turn, allows Russia to point to the part of the UN Charter that declares "the principle of equal rights and self-determination of peoples," as well as the evolving doctrine allowing foreign intervention when there are humanitarian concerns for the safety of some oppressed minority population elsewhere.

The reality is that international law offers no straightforward solution to the crisis in Ukraine. The content of the rules is debatable, their applicability is unclear, and their effective enforcement is unlikely. The parties — all of them, including Russia — are largely stuck with the costs, and they continue to inflict more costs on one another.

A Market Alternative

It did not have to be this way. Even assuming that Crimea was inevitably going to end up a part of Russia, international law could have facilitated a peaceful transfer that would have helped align the parties' interests rather than putting them at odds. The mechanism for this is what we call a "market for sovereign control." The idea is straightforward. If one country (say, Russia) values a region (Crimea) in another country (Ukraine) enough, it should be willing to pay for it. If the people of the region and the parent country agree to the offer price, then the border can be moved without any need for chest-pounding and troop movements.

Consider the facts we know. Ukraine has almost certainly lost Crimea and now faces further dismemberment, violence and economic ruin as a result of the separatist movements in the Southeast. How much better would it have been for Ukraine if it could have given up Crimea peacefully in exchange for debt relief, cheap gas and perhaps even Russian help tracking down the money that the prior corrupt government apparently stole?

As for Russia, one might think it has no incentive to pay for what it can simply take. But that is not necessarily so. After all, the acquisition has been expensive and will continue to be. In addition to its basic out-of-pocket costs, Russia faces large numbers of refugees, economic sanctions, loss of trade and political isolation from the West. If it could acquire Crimea while avoiding those costs, it surely would be willing to pay a premium.

As long as the people of Crimea agreed with the change, such a transfer would have the further benefit of legitimacy under international law — something that is murky at best under the current state of affairs. International law recognizes traded borders and permits countries to cede territory to one another almost without limit. Indeed, more than half of the United States' sovereign territory was acquired through three purchases from other sovereigns: the Louisiana Purchase (France), Alaska Purchase (Russia) and the Treaty of Guadalupe Hidalgo (Mexico). These are in no way unique — the world map as we know it was shaped in large part by sales of sovereign territory throughout history.

Of course, not all of this history is to be

A DOCTRINE OF ODIOUS DEBTS?

The standard rule of governmental succession in public international law is a strict one. Governments are obligated to honor their predecessors' debts, regardless of their political and philosophical differences with the prior regime. Over time, however, there have been attempts to articulate exceptions to the general rule. One of these is the doctrine of odious debts.

Credit for the first formal articulation of this idea is generally given to a Russian émigré in Paris (subsequently a law professor at New York University), Alexander Nahum Sack. Writing in 1927, Sack defined odious debt as that which is (i) contracted by a "despotic" power, (ii) for a purpose that is not in the general interests or needs of the state and (iii) which the lender knows the proceeds of will not benefit the nation as a whole.

Part of the inspiration for Sack's definition undoubtedly came from Communist Russia's disavowal of the enormous stock of debts that the tsar had accumulated in the decades prior to his overthrow in 1917. The logic was simple: the prior ruler had been a despot, the debts were his and not those of the people and the creditors — particularly the foreign ones — should bear the risk that the despot they had funded would be overthrown. Some decades later, using much the same logic, the Communists in China refused to repay the debts of their Imperial predecessors. Those two sets of debts remain unpaid to this day, with periodic quixotic attempts by the holders of the now antique debt certificates to have them enforced.

While the Communist disavowals of the predecessor monarchies' debts were certainly the biggest applications of the idea of odious debts, its origins as a legal doctrine might actually have had its roots in an American-arbitrated dispute involving Great Britain and Costa Rica. William Howard Taft (a former Yale law professor, colonial administrator of the Philippines, US president and then Chief Justice of the US Supreme Court) served as the sole arbitrator.
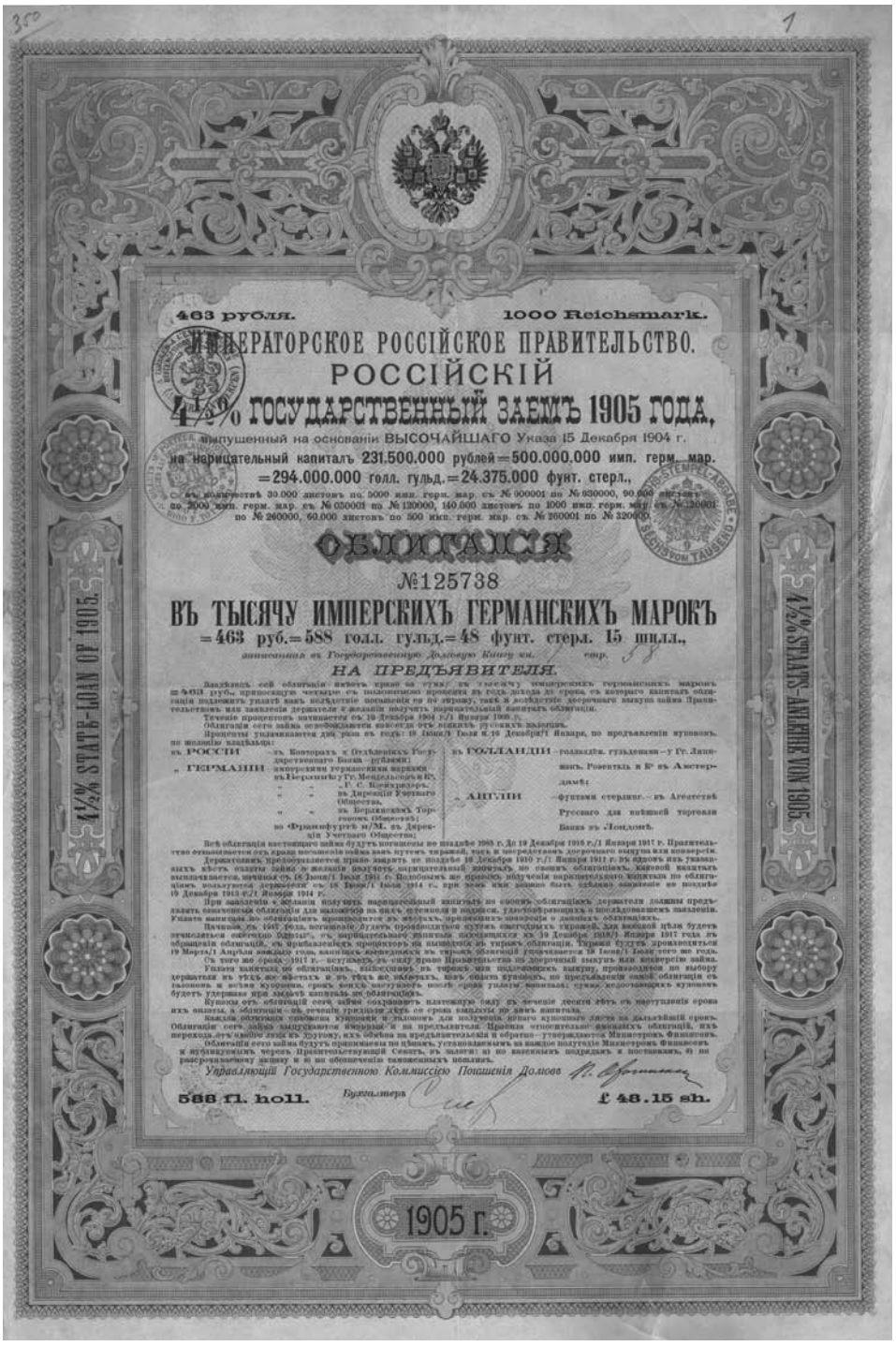
The facts were these: In January 1917, Frederico Tinoco and his brother overthrew the government of Costa Rica. His government lasted two years. Before he left the country, however, Tinoco managed to borrow some money from the Royal Bank of Canada. That money also left the country...in the company of Tinoco. In a subsequent arbitration brought against Costa Rica for repayment of the debt, Taft ruled that Costa Rica was not responsible for the debts of F. Tinoco. He explained that the bank had known that this money was to be used by the retiring president for his personal support after he had taken refuge in a foreign country. This debt was, therefore, not the responsibility of the successor government — it was the personal responsibility of Tinoco.

The foregoing moments in history are periodically resuscitated whenever an apparently despotic government is overthrown and its successor government finds itself saddled with a big set of its predecessor's debts. But despite the moral appeal of such a doctrine, it has never come close to receiving full-fledged support from the community of nations.

The closest it has come in recent years was in the wake of Saddam Hussein's overthrow in Iraq by the US-led coalition. Hussein left his successors with a debt stock in the vicinity of $100 billion. Unsurprisingly, given that a good portion of those funds had likely been used to oppress them, his successors did not want to repay those debts. Ultimately, the successor government in Iraq did not follow the strategy of the Russian and Chinese Communist governments and do a blanket repudiation of the prior regimes. But it did manage to extract an unprecedented (particularly for a country with the kinds of revenue-generating resources that Iraq had) debt reduction from the creditors (a haircut of about 80%). It is likely that Hussein's despotism — and the complicity of creditors in helping keep his regime in place for longer than it would have otherwise lasted — impacted the level of debt reduction.

Can one say there is a doctrine of odious debts in public international law? There are those who say so. The authors' view is that there has not yet developed enough of an international consensus on the matter for such a doctrine to be proclaimed. Still, there is something there. It may not be a full-fledged doctrine yet, but it would not take much to get there.

This draws on Lee C. Buchheit et al., "The Dilemma of Odious Debts," 56 Duke Law Journal *1201 (2007).*



Defaulted Russian czarist bond, 1905.

which creates, in effect, the possibility of regional immigration — of a territorially-concentrated people altering their national identity by choice.

In the context of a market for sovereign territory, the principle of self-determination would mean that the people of an affected region must be able to vote on any proposed sale. The need for their approval would prevent colonial-style territory-trading, while increasing domestic political pressure on countries to keep their people happy.

There are many strong objections to the idea of a market for sovereign territory: that it would inappropriately undermine democracy, commodify people and sovereignty, give rich nations even more power, encourage corruption, create instability and give a veneer of legitimacy to coercion. But, as the situation in Ukraine demonstrates, we must be realistic about the alternatives. Sovereign debt can be coercive, but rarely more so than soldiers — better that Putin send bonds to Ukraine than troops. Perhaps there is something discomfiting about "commodifying" sovereign territory, but whether or not is it is treated like an asset, it can certainly be lost — as the people of Ukraine know all too well. Secessions and border changes will continue to happen whether or not compensation is involved. If people can't buy territory, they might just take it.

It is common to see signs in shops warning: "You break it, you bought it." The idea is to encourage people to exercise care with what does not belong to them, and to buy things rather than breaking them and sticking someone else with the cost. With the right system in place, Russia could have bought Ukraine instead of breaking it. The countries and their people would likely be much better off. **$**

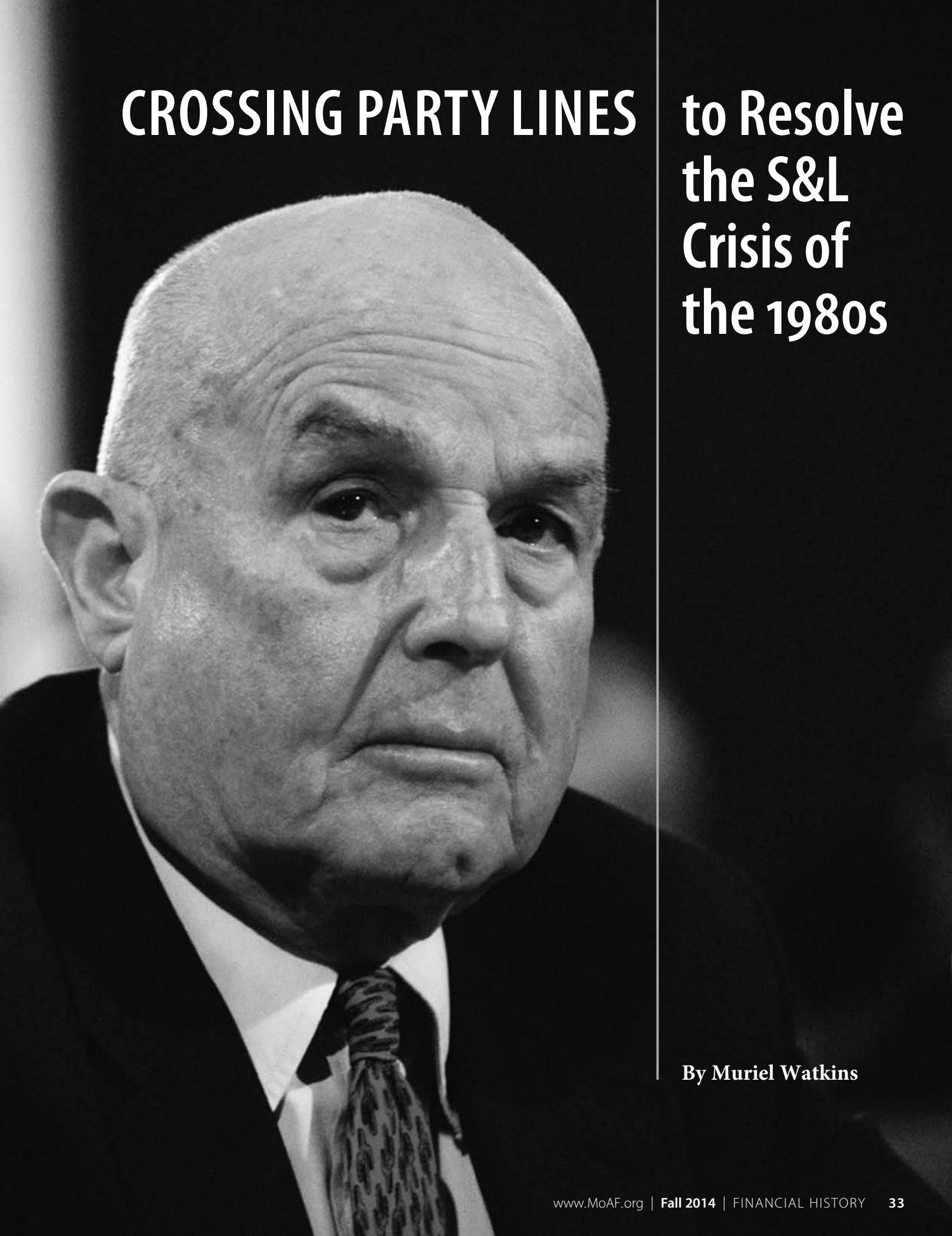
celebrated. Without proper protections, buying and selling sovereign territory can be a sordid, undemocratic and outright coercive affair. One need look no further than the United States' "purchase" of land from Native Americans.

But international law has developed tools to address that kind of oppression, and they might be put to good use here. One important limitation that has evolved since the colonial era is that of self-determination, which would guarantee people's right to choose their national identities. International law has increasingly recognized this principle (it might still be too soon to call it an enforceable doctrine),

Joseph Blocher and Mitu Gulati are both law professors at Duke University. This article builds substantially on a piece that Professors Blocher and Gulati published in the Financial Times *(Alphaville) earlier this year.*

See Blocher and Gulati, What if Putin Had Bought Crimea?, *available at http://ftalphaville.ft.com/2014/04/07/1821382/guest-post-what-if-putin-had-bought-crimea/.*

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CROSSING PARTY LINES to Resolve the S&L Crisis of the 1980s

By Muriel Watkins

TABLE 1: Ten Most Costly S&L Failures, 1980–1994

Financial Institution	Location	Failure Date	Assets	Resolved By
Lamar Savings Association	Austin, Texas	May-88	$1,919	FSLIC
American Savings and Loan Association	Stockton, California	Sep-88	$33,841	FSLIC
Sunbelt Savings Association	Dallas, Texas	Sep-88	$2,214	FSLIC[1]
Guaranty Federal Savings and Loan Association	Dallas, Texas	Sep-88	$1,961	FSLIC[1]
Gibraltar Savings Association	Houston, Texas	Dec-88	$6,398	FSLIC[1]
First Texas Savings Association	Dallas, Texas	Dec-88	$2,920	FSLIC[1]
University Federal Savings Association	Houston, Texas	Feb-89	$3,762	RTC
Lincoln Savings	Irvine, California	Apr-89	$5,374	RTC
Western Savings and Loan Association	Phoenix, Arizona	Jun-89	$6,467	RTC
San Jacinto Savings Association	Houston, Texas	Nov-90	$2,228	RTC

Source: *The FDIC and RTC Experience: Managing The Crisis,* FDIC, August 1998.

Assets at time of resolution for FSLIC transactions or at time of takeover for RTC resolutions. [$ in thousands]

FSLIC[1] — Resolved as a part of Southwest Plan.

They came to their unplanned collaboration from distinctly different paths — Henry B. Gonzalez, the descendent of industrious Mexican immigrants, and L. William Seidman, the Michigan accountant's son. Despite their divergent roads to influence, both men were ardent devotees of straight talk and integrity. These traits would help define their approach to the resolution of the Savings & Loan Crisis of the 1980s.

Surely, "crisis" is not too strong a term to define the events of this period in US financial history. The thrift and banking industries suffered losses to the deposit insurance funds estimated at more than $125 billion. Moreover, the reforms that resulted, and the approach to their resolution, provided guidance for future regulators faced with equally daunting circumstances.

Elected to Congress in 1961 from the state of Texas, Rep. Gonzalez rose to Chairman of the House Banking, Finance and Urban Affairs Committee in 1989. Between 1989 and 1995 — the 101st and 102nd Congressional sessions — Chairman Gonzalez spearheaded the passage of legislation to resolve the S&L Crisis and bank failures. He worked closely with Seidman, appointed by President Reagan as the 14th Chairman of the Federal Deposit Insurance Corporation (FDIC), in this effort. The two would work closely to craft laws to manage the financial crisis facing both thrifts and banks. A more immediate and important piece of legislation to result from this collaborative effort was the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA).

Shortly after his inauguration in January 1989, President George H.W. Bush proposed a plan to close 350 insolvent savings and loans and reorganize the thrift federal financial regulatory system. Having warned about potential losses related to deregulation of the savings and loan industry, Chairman Gonzalez took quick action to stem the losses and reform the thrift industry. In addition to restructuring thrift regulation and the insurance fund, FIRREA abolished the Federal Home Loan Bank Board (FHLBB) and the Federal Savings and Loan Insurance Corporation (FSLIC) with a transfer of thrift assets to the management of the FDIC to dispose of failed thrift institutions and assets under an interim entity, the Resolution Trust Corporation (RTC).

Previous page: Portrait of L. William Seidman, 14th chairman of the FDIC.

As Congress was focused on the S&L Crisis, bank failures were also increasing and depleting the bank insurance fund. On the first day of the 102nd Congress, Gonzalez introduced legislation that he considered to be the highest priority: deposit insurance reform.

> Today we must confront the task of rebuilding the bank insurance fund and reform the way the deposit insurance system is administered… This must be a system that is operated in a safe and sound manner, that is well regulated, and that is capable of operating in a profitable manner. …The highest priority my committee has is to overhaul the banking system, and that task must begin immediately… I am introducing legislation today that addresses major elements of the deposit insurance system's problems and that overhauls the regulatory system for all depository institutions. It will be known as H.R.6. The bill I am offering today concentrates on safety and soundness because this is what must come before all else in banking and finance… (Congressional Record, January 3, 1991, H43–H46)

Chairman Gonzalez's bill called for early intervention with troubled banks, limits on deposit insurance to $100,000 in all accounts, the end of the regulators' "too big to fail" policy, limits on state powers and risk-based deposit insurance premiums.

In addition to the duties inherent in his position as Chairman, Gonzalez was also motivated by political self-interest. As a Congressional representative from Texas, Gonzalez witnessed the failure of 245 S&Ls in the state of Texas, representing approximately 29% of the 1,295 failures during the 1980s. In 1988, the FHLBB approved 15 assisted transactions in Texas involving 87 insolvent thrifts at a projected resolution cost of $44 billion.

Because of the large number of insolvent thrifts in Texas, the FHLBB consolidated a number of insolvent thrifts into 15 prearranged packages for sale under a resolution strategy, the Southwest Plan deals. After the November 1988 election, the incoming Bush administration decided to remove the FHLBB and FSLIC

TABLE 2: Five Largest Bank Failures, 1980–1994

Financial Institution	Location	Failure Date	Assets
Continental Illinois National Bank & Trust	Chicago, Illinois	17-May-84	$33,633
First Republic Bank Corporation	Dallas, Texas	29-Jul-88	$33,448
Bank of New England	Boston, Massachusetts	6-Jan-91	$21,754
MCorp	Dallas, Texas	28-Mar-89	$15,749
First City Bancorporation	Houston, Texas	20-Apr-88	$11,200

Source: *The FDIC and RTC Experience: Managing The Crisis,* FDIC, August 1998.

Assets at resolution, includes affiliated failed banks. [$ in thousands]

as the insurer of thrifts and to transfer that authority to the FDIC (see Table 1).

Additionally, 599 Texas banks failed during the 1980s, approximating 37% of the 1,617 bank failures. Three of the five largest bank failures between 1980 and 1994 were in Texas (see Table 2).

In addition to scheduled Congressional hearings, Chairman Gonzalez engaged the resources of the General Accounting Office (GAO) to review the condition, cost and resolution strategy of insolvent thrifts and banks. At the beginning of his term as Chairman of the Committee on Banking, Finance and Urban Affairs, the GAO began providing a series of reports and providing recommendations and testimony on the state of the thrifts. In several of the reports, GAO noted that the strategy for resolving insolvent institutions was costly and did not consider the total cost to the government of resolving insolvent thrifts.

By March, the GAO Comptroller General, Charles A. Bowsher, testified before the House Committee on Banking, Finance and Urban Affairs, with recommendations for resolving the crisis in the thrift industry. The recommendation called for merging the FSLIC with the FDIC, authorizing the FDIC to serve as manager for the combined entity with control of thrift assets as the RTC.

Chairman Gonzalez continued to engage the services of the GAO to review the conditions and issues contributing to failures in the banking industry. After a series of published GAO reports, the Director of Planning and Reporting of the GAO's General Government Division testified on proposals to resolve large bank failures. This testimony would be included in consideration leading to the passage of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA).

As an accountant who had served as a managing partner of his family's accounting firm, FDIC Chairman Seidman warned that the FSLIC was not adequately representing the losses from failed thrifts. His warnings drew the attention of the Bush Administration and Congressman Gonzalez and, no doubt, influenced decisions leading up to the passage of the Financial Institutions Reform, Recovery and Enforcement Act of 1989.

Seidman placed a premium on establishing a working relationship with Congress and regardless of party affiliation. Working with the FDIC legislative affairs staff, Seidman spent time on Capitol Hill meeting with members of the House and Senate banking committees. He also invited members of Congress to breakfast meetings at the FDIC, noting "that proved a fine grounding for good relations."

Rep. Gonzalez attended several breakfast meetings. Seidman appreciated his knowledge of US banking history, which he had gained through his committee assignments and the laws it had passed and defeated. Gonzalez appreciated Seidman's analysis and research that supported projections on the financial crisis and his touch approach to managing the resolution of failed banks.

During the first RTC Congressional Hearing before the House Banking, Finance and Urban Affairs Committee in January 1990, Chairman Gonzalez requested time to follow-up on a question posed by Congressman Hoagland (D-Nebraska) to FDIC Chairman Seidman regarding deposit insurance. Chairman Gonzalez questioned "the legality and the power and the authority to pay out to the over $100,000 insured depositor" and raised the issue of "too big to fail."

"I am happy to see that your usual forthrightness in answer to Mr. Hoagland's or by implication questioning this too big to fail business." In this context he raised the example of the failure of Continental Illinois and acknowledged Seidman's intervention to prevent a golden parachute with a $2 million annual pension, noting, "And I wanted the record to show that you put a stop to that…"

In addition to passing legislation to resolve the S&L Crisis, Gonzalez worked closely with Seidman to introduce legislative provisions to reform banking that led to passage of the FDICIA in 1991. Seidman wrote a book detailing his involvement during this period, titled *Full Faith and Credit: The Great S&L Debacle and Other Washington Sagas*. In the closing chapter, "With All That Experience, What Have You Learned?," Seidman added the following section: "The Congress — Friend or Foe?" to highlight his understanding of the relationship in working with Congress.

"Each and every member of Congress is different in personality, ability, reliability and constituent interests. Some are in safe districts, and some face a battle every two years. Thus, like the press, dealing with Congress is a misnomer. Dealing with individuals — Chairman Gonzalez or Congressman Schumer, Leach or Wylie — is a more accurate way to describe the challenge."

By the end of Seidman's tenure as Chairman of the FDIC and RTC, the RTC had developed a range of effective sales strategies to liquidate assets from failed thrifts, bank failures had decreased and profits were on the rebound. Legislative provisions passed under FDICIA helped recapitalize the Bank Insurance Fund. **$**

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Unforgiven

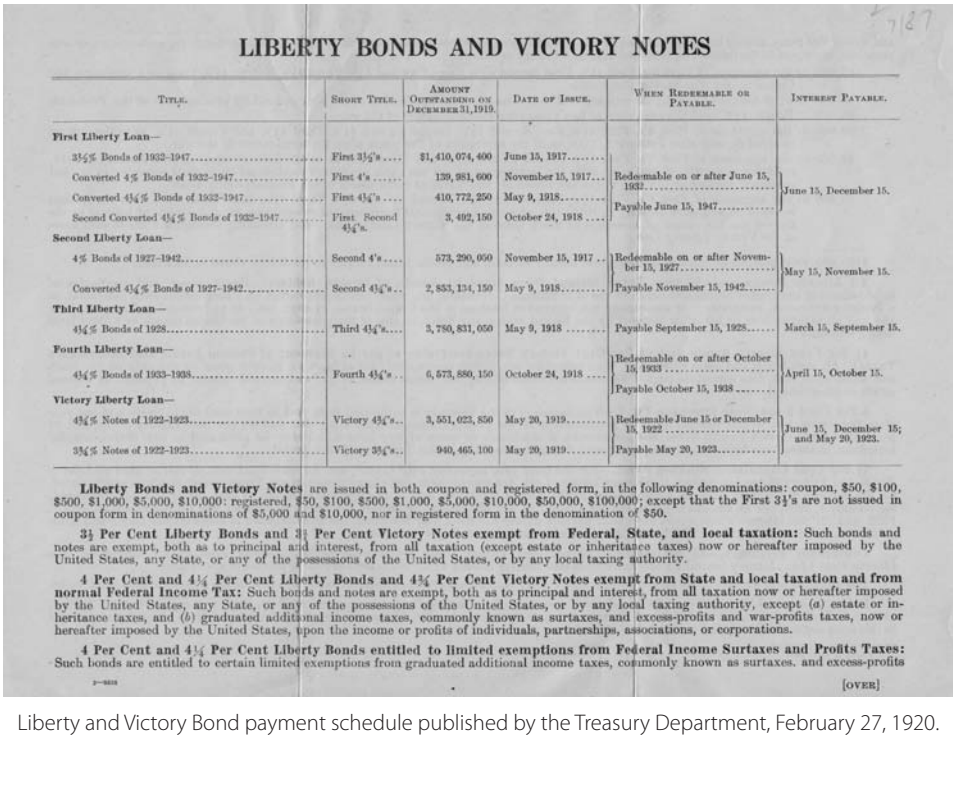
continued from page 19

sensed President Harding's more conciliatory tone about the debt. But they had also antagonized him and Treasury Secretary Mellon with their August 1922 publication of the Balfour Note. That letter from Acting Secretary of State for Foreign Affairs Arthur Lord Balfour to the French ambassador to Great Britain stated a new policy towards its war-related debts. The British government would only collect from its debtors sufficient funds to repay its loans to the United States; it would forgive any debts over that amount. The letter implied that the United States should also consider forgiving portions of its loans.

After much political blustering on both sides of the Atlantic, and a change in the British government, in December the new Prime Minister, Andrew Bonar Law, sent a delegation to Washington to discuss the restructuring and eventual repayment of the American loans. He gave that five-man delegation some authority to restructure the debt, but he also set some limits on the terms his government would be willing to accept.

On the US side of the table, Treasury Secretary Mellon and Commission member and Secretary of State Charles Evans Hughes recognized the practical difficulties Great Britain would have in trying to repay its loans in complete accordance with the terms set by Congress when it established the Debt Commission. The Commissioners acted on their own in considering that debtor nation's ability to pay in negotiating a restructuring agreement and exhibited a great deal of flexibility in adjusting its terms. It took the British and American negotiators only a few weeks to agree on the basic outline of a plan that would convert Great Britain's $4.6 billion demand note to a 62-year term loan, with an interest rate of 3% for the first 10 years and 3.5% thereafter.

Prime Minister Law considered those terms totally unacceptable. Two members of the British negotiating team, Chancellor of the Exchequer Stanley Baldwin and Governor of the Bank of England Montagu Norman, finally persuaded him that accepting this proposal would free their country to deal with the still-pressing problems of European rehabilitation. In further negotiations during the next few months, the British gained the additional flexibility to repay the principal in US Liberty Bonds rather than cash, and to postpone those principal payments periodically. As noted above, the parties formally signed this important and precedent-setting restructuring agreement in June 1923.



LIBERTY BONDS AND VICTORY NOTES

Title.	Short Title.	Amount Outstanding on December 31, 1919.	Date of Issue.	When Redeemable or Payable.	Interest Payable.
First Liberty Loan—					
3½% Bonds of 1932-1947	First 3½'s	$1,410,074,400	June 15, 1917		
Converted 4% Bonds of 1932-1947	First 4's	139,981,600	November 15, 1917	Redeemable on or after June 15, 1932	June 15, December 15.
Converted 4¼% Bonds of 1932-1947	First 4¼'s	410,772,250	May 9, 1918	Payable June 15, 1947	
Second Converted 4¼% Bonds of 1932-1947	First Second 4¼'s.	3,492,150	October 24, 1918		
Second Liberty Loan—					
4% Bonds of 1927-1942	Second 4's	573,290,050	November 15, 1917	Redeemable on or after November 15, 1927	May 15, November 15.
Converted 4¼% Bonds of 1927-1942	Second 4¼'s	2,853,134,150	May 9, 1918	Payable November 15, 1942	
Third Liberty Loan—					
4¼% Bonds of 1928	Third 4¼'s	3,780,831,050	May 9, 1918	Payable September 15, 1928	March 15, September 15.
Fourth Liberty Loan—					
4¼% Bonds of 1933-1938	Fourth 4¼'s	6,573,880,150	October 24, 1918	Redeemable on or after October 15, 1933 / Payable October 15, 1938	April 15, October 15.
Victory Liberty Loan—					
4¼% Notes of 1922-1923	Victory 4¼'s	3,551,023,850	May 20, 1919	Redeemable June 15 or December 15, 1922	June 15, December 15; and May 20, 1923.
3¾% Notes of 1922-1923	Victory 3¾'s	940,465,100	May 20, 1919	Payable May 20, 1923	

Liberty Bonds and Victory Notes are issued in both coupon and registered form, in the following denominations: coupon, $50, $100, $500, $1,000, $5,000, $10,000: registered, $50, $100, $500, $1,000, $5,000, $10,000, $50,000, $100,000; except that the First 3½'s are not issued in coupon form in denominations of $5,000 and $10,000, nor in registered form in the denomination of $50.

3½ Per Cent Liberty Bonds and 3¾ Per Cent Victory Notes exempt from Federal, State, and local taxation: Such bonds and notes are exempt, both as to principal and interest, from all taxation (except estate or inheritance taxes) now or hereafter imposed by the United States, any State, or any of the possessions of the United States, or by any local taxing authority.

4 Per Cent and 4¼ Per Cent Liberty Bonds and 4¼ Per Cent Victory Notes exempt from State and local taxation and from normal Federal Income Tax: Such bonds and notes are exempt, both as to principal and interest, from all taxation now or hereafter imposed by the United States, any State, or any of the possessions of the United States, or by any local taxing authority, except (*a*) estate or inheritance taxes, and (*b*) graduated additional income taxes, commonly known as surtaxes, and excess-profits and war-profits taxes, now or hereafter imposed by the United States, upon the income or profits of individuals, partnerships, associations, or corporations.

4 Per Cent and 4¼ Per Cent Liberty Bonds entitled to limited exemptions from Federal Income Surtaxes and Profits Taxes: Such bonds are entitled to certain limited exemptions from graduated additional income taxes, commonly known as surtaxes, and excess-profits

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Museum of American Finance

Liberty and Victory Bond payment schedule published by the Treasury Department, February 27, 1920.

Dealing with France

France first sent a representative to the Debt Commission in August 1922. At the time, however, Premier Raymond Poincare instructed Jean Parmentier, Director of Capital at the French Ministry of Finance, to announce his country's unwillingness to discuss the settlement of its debts to the United States, and its inability to satisfy them in only 25 years. When the French government found the financial resources to occupy the Ruhr region of Germany in January 1923, the Harding Administration inquired further about its capacity to begin repaying its debts; but it took no further action to bring the French to the Debt Commission's negotiating table. After Harding's death in August, successor Calvin Coolidge expressed his agreement with the long-standing American belief that the debts must be fully repaid. (Regarding the potential canceling of some debts, historians don't believe he actually made the famous comment "They hired the money, didn't they?")

After his election in his own right in November 1924, Coolidge authorized the State Department to temporarily block a loan to France from the private banking firm J.P. Morgan & Company, and to hint at long-lasting restrictions on that country's ability to borrow from any US source. In response, French Ambassador Jules Jusserand let Treasury Secretary Mellon know his government was indeed willing to begin discussing a restructuring of its war-related debts. Near the end of the year, Mellon suggested the Debt Commission was prepared to offer the French repayment terms similar to those granted to Great Britain and three other countries during the past 18 months.

That same month, French Finance Minister Etienne Clementel proposed a settlement to American Ambassador Myron Herrick. He suggested a complete moratorium on payments for 10 years, no interest for the following 10 years and an interest rate of 0.5% for the following 90 years. Mellon quickly rejected the offer. Clementel made another proposal in March 1925, calling for a term of 83 years and an average interest rate of about 1.4%. It also called for a "safeguard" clause that would allow France to limit its payments to the United States only to the amount of reparations it received from Germany. Herrick thought the proposal was a good starting point for negotiations. He had heard Republican Federation President Louis Marin's January 1925 speech to the Chamber of



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Congressman Hiram Johnson pushed through Congress the Johnson Debt Default Act, which prohibited the government from making loans to any country that had not repaid its war debts.

Deputies and appreciated the negative attitude many French citizens had towards the US policy of collecting 100% of its war debts. Secretary of State Frank B. Kellogg rejected both his ambassador's advice and Clementel's revised proposal.

In May 1925, new French Finance Minister Joseph Calliaux proposed a 10-year payment moratorium and a new term of 80 years. Secretary Kellogg rejected that overture and asked Ambassador Herrick to solicit a French response to Secretary Mellon's December 1924 suggestion. In July, French Foreign Minister Aristide Briand announced his government's intention to send negotiators to the Debt Commission. In September, a delegation led by Finance Minister Calliaux arrived in Washington. Four months of negotiations led nowhere, and both critics and defenders of the US's policy loudly communicated their views in the media.

In February 1926, the new French Ambassador to the United States, Henry Berenger, presented a 140-page document titled "France and Her Capacity to Pay" to Treasury Secretary Mellon. After two months of discussions, negotiators agreed on the essence of a restructuring agreement with a payment term of 62 years, an average interest rate of about 1.6% and no safeguard clause. However, the agreement signed in late April would not be ratified in the US Congress and the French National Assembly until December 1929.

It Was All For Naught

By the time the French refunding agreement was finalized, the *Sturm und Drang* over the United States' attempts to collect its inter-allied war debts had lasted longer than the Debt Commission's five-year term. For all its difficulties, that Commission had negotiated restructuring agreements to collect more than 97% of the principal amount of the war debts. The ink was barely dry on the French refinancing agreement when the world's economies began sliding into an historic depression. Yet, most debtors continued to make payments throughout 1930 and into 1931. With conditions worsening by the month, however, in June 1931 President Herbert Hoover called for a one-year moratorium on the payment of all inter-allied debts. At that point, the United States had collected only 4% of the amount it was owed. President Hoover reinforced the legal rationale behind the adjusted debt repayment schedules and did not suggest any cancellations. He only suggested that the moratorium would provide some temporary relief for countries coping with what he believed would be a temporary economic downturn.

All of the country's creditors took advantage of what technically turned out to be a two-year moratorium. Unfortunately, economic conditions continued to worsen around the world. In the fiscal year ending June 31, 1932, the United States received almost $98 million of the $125 million it was due that year. In the following fiscal year it received only $11 million of the $143 million that was due. And in fiscal year 1934, it received token payments of less than $9 million. No country would ever pay another dime of its obligations.

An Unintended Consequence

In April 1934, Congressman Hiram Johnson was more than a little aggravated at the total of almost $22 billion (principal plus interest) in unpaid loans from the Great War. He pushed through Congress the Johnson Debt Default Act, which prohibited the government from making loans to any country that had not repaid those debts. President Franklin D. Roosevelt signed it, largely in keeping with America's new isolationism. It is unlikely he realized at the time how it would hamstring him in 1941. By that time he recognized the need to supply Great Britain and other allies with munitions, industrial materials and agricultural products in their attempt to prevent Germany from overtaking the globe. Since the Johnson Act prevented the government from lending any money to those countries, President Roosevelt pushed through Congress the Lend-Lease Act of 1941 that gave him the authority to provide some much-needed aid. **$**

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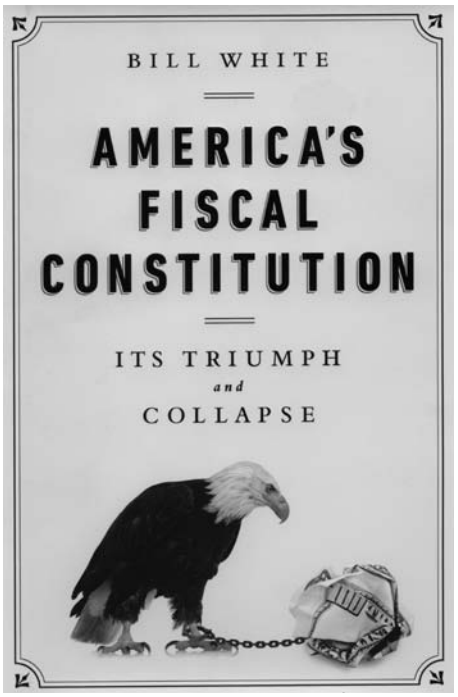
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America's Fiscal Constitution: Its Triumph and Collapse



By Bill White
PublicAffairs, 2014
576 pages with notes and appendices

Every policymaker, politician and pundit in America should read this book, even though author Bill White, a longtime Democratic mayor of Houston turned investment banker, might seem at first blush an unlikely policy hero. White's weighty tome (500+ pages) would qualify as a doctoral dissertation at any university in the world because it contains more than 40 pages of notes, almost 40 pages of bibliographic entries and nearly 40 pages of statistical appendices reconstructed from original sources. Most impressively of all, the end result is not a partisan political screed but a highly-readable and well-balanced account of the rise and demise of America's unwritten fiscal constitution, the set of budgetary rules that made the United States one of the world's most creditworthy nations in the 19th and 20th centuries.

White shows that US lawmakers long countenanced only four acceptable uses of debt: preservation of the union; expansion of the nation's borders; waging of war and keeping the government afloat during recessions. After each war, expansion and recession, the federal government stopped borrowing and sometimes even ran surpluses. That, combined with robust economic growth, prevented the national debt from ballooning out of control and kept the country's credit strong, ready for use during the next emergency or opportunity.

Along the way, White introduces readers to numerous policymakers, from obvious players like Alexander Hamilton and Thomas Jefferson to less well-known lawmakers like "Muley Bob" Doughton, Chairman of the House Ways and Means Committee during the 1950 budget fight between President Harry Truman and Senator Robert Taft of Ohio (son of former President William Howard Taft). White also peppers the book with gems of wisdom rarely presented with such sterling clarity. For example, he blasts pro-debt theorists — a new breed of economist/policymaker who claim that deficit financing can stimulate economic growth (higher per capita income) — by explaining that "long run economic growth results from a growing and productive workforce, not greater debt" (p. 13).

Today, the federal government continuously violates the fiscal constitution by borrowing to cover general expenses and by engaging in extensive accounting legerdemain. The demise of the country's fiscal tradition did not happen all at once, White shows, and was not the result of any one event, president or party.

Rather, the fiscal constitution degenerated over decades before finally collapsing completely during the first term of George W. Bush. Lowering, rather than raising, tax rates during the War on Terror (2001–present) was only the most obvious breach of the tradition.

White suggests that America's fiscal constitution could be reconstituted through a few, simple-to-implement reforms. First and foremost, the budget needs to be made, in Jefferson's words, "clear and intelligible" to "any man of any mind" (p. 363). That means producing a tax-financed budget based on good faith revenue estimates updated monthly. Any appropriations above the tax-financed budget need to be clearly distinguished as such and voted on separately so that voters can readily identify politicians who want to borrow and spend instead of make difficult choices about tradeoffs.

Second, the debt ceiling system needs to be dismantled because Congress votes on the ceiling only after it has voted to spend more than its tax revenues.

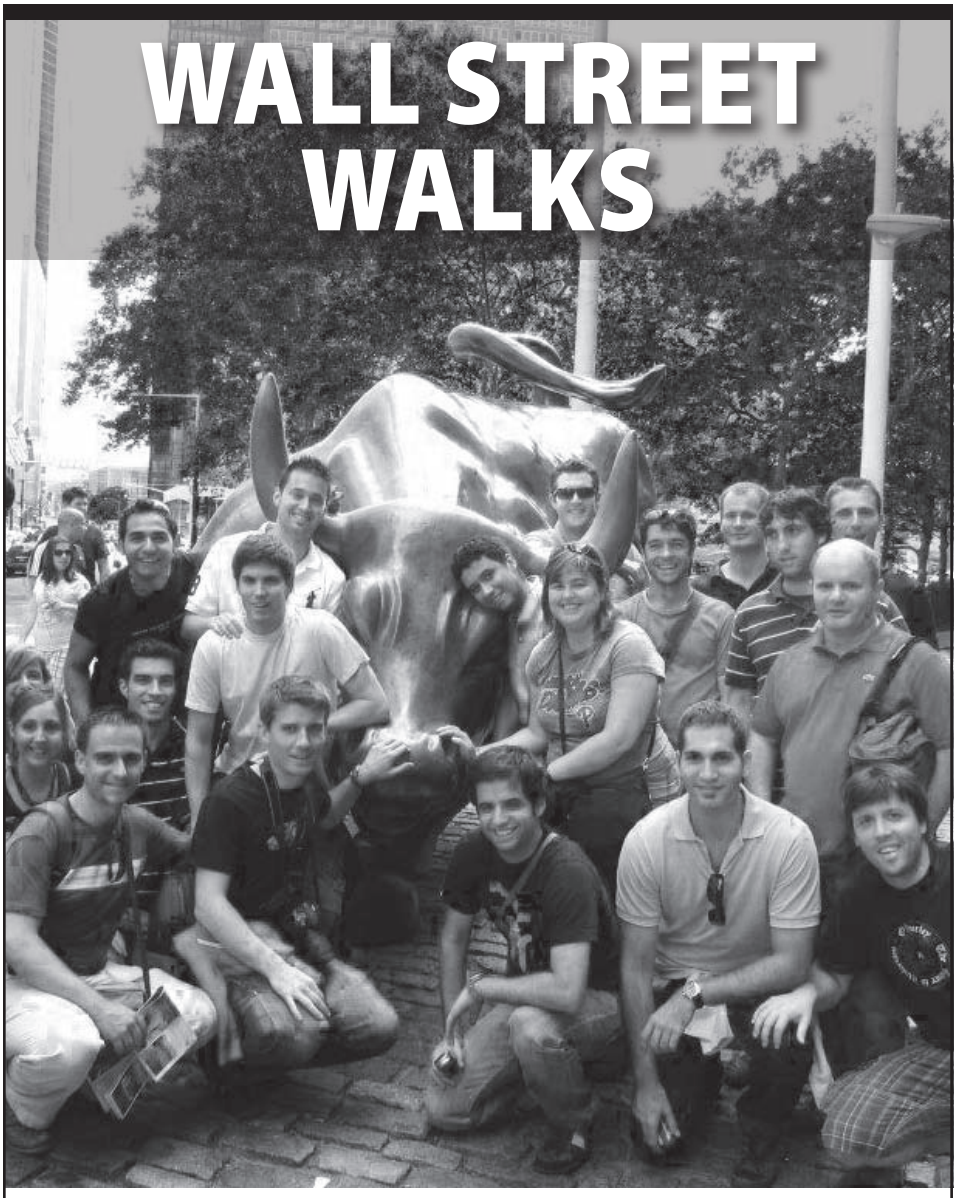
Third, bond issue votes, like the thousands held annually at the state and municipal levels, should be held at the federal level as well.

"Nothing," White argues, "prevents Congress from holding a national referendum on whether to incur federal debt for specific purposes and amounts" (p. 369). Since 1970, he notes, state and local debt levels have grown at only half the federal rate.

White concludes by optimistically opining that Democrats and Republicans, with a little push from voters, are ready to work together to reinstate the nation's budgetary traditions. Perhaps what the nation really needs, though, is a statesman-scholar like White to lead the way. **$**

Robert E. Wright is the Nef Family Chair of Political Economy at Augustana College in South Dakota and a member of this magazine's editorial board. He is the author of more than 15 books including One Nation Under Debt *(2008) and is the co-author, with Museum Chairman Richard Sylla, of* Genealogy of American Finance *(Columbia Business School Publishing, Spring 2015).*

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3. What city was home to the first stock exchange in the United States?

4. How many central banks has the United States had?

5. In what country was Albert Gallatin, Secretary of the Treasury from 1801–1814, born?

6. What federal agency was created in 1865 to suppress counterfeiting?

7. What founding father and early American inventor was also a well-known currency printer?

8. What exchange was once called the "New York Curb Exchange" because it conducted its business outdoors?

9. In what year did the NYSE open in its current home on the corner of Wall and Broad Streets?

10. In addition to Wells Fargo, which modern company was founded by Henry Wells and William Fargo?

1. Scrip **2.** 1929 **3.** Philadelphia **4.** Four (The Bank of North America, as nominal central bank; First Bank of the US; Second Bank of the US; and the Federal Reserve) **5.** Switzerland **6.** The US Secret Service **7.** Benjamin Franklin **8.** American Stock Exchange **9.** 1903 **10.** American Express

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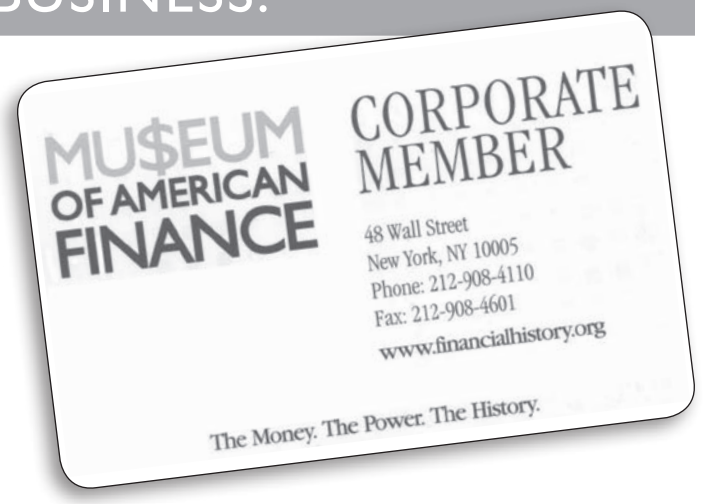
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